ISLAMIC ECONOMICS

An Introductory Analysis

M. A. Hamid

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DEDICATED TO

WHOM WHOSE WRITINGS (AS GIVEN IN THE LIST OF REFERENCES) HAVE HELPED ME IN PREPARING THIS TEXTBOOK. I AM GRATEFUL TO ALL OF THEM. THE FIRST 19 SUCH WRITERS WHOSE WRITINGS I HAVE COME ABOUT MOST FREQUENTLY DESERVE SPECIAL MENTION:

Ausuf Ahmad
Khurshid Ahmad
Ziauddin Ahmad
Monjoor Ali
M. Umer Chapra
F. R. Faridi
Munawar Iqbal
S. A. Hamid Junaid
Monzer Kahf
M. Akram Khan
M. Fahim Khan
Waqar M. Khan
M. A. Mannan
Abbas Mirakhor
A. H. M. Sadeq
Nejatullah Siddiqi
Rodney Wilson
Hasanuz Zaman
Anas Zarqa

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PART -II: MICROECONOMICS

PART - VI: INTERNATIONAL TRADE

PART VII: ECONOMIC DEVELOPMENT

Preface

Mixed emotions runs through me as I am preparing to write the preface of this book of my beloved father, Prof. M.A. Hamid (May Allah grant him eternal peace in the Heaven). It was sometimes in 1998 when I insisted my father to finish this book at my home in Texas, USA while he was in his sabbatical leave. To my surprise, I have recently found the first draft in one of my backup disks, that we typed together. At that time, I had no knowledge of Islam nor had I any clue in Economics. After all these years, I find it fascinating to read the draft copy and regret why I had no chance to discuss the topics with him in order to gain more in-sights into his thought process.

In a quick glance, I estimated more than 40 ayats from the Holy Quran has been used in this book to explain the theology of Islamic Economics. For someone like me with no economics background, those 40 ayats were enough to understand the essence of this subject. I have started compiling those ayats with relevant tafsîrs to make this subject interesting to the general public and thus realize what the Quran says about the Islamic economics system–which I found far more than just the subject of *Riba* itself. The ppt file may be available upon request.

Even though the first manuscript was written in English, the publication of the Bengali translated version book was made in 1999 and the second edition came out in 2002, just before my father passed away. I am in spirit what he has mentioned at the end of the introduction of the second edition – the best charity is when someone teaches the Quranic knowledge. May Allah make this book a source of *Sadaqa Jâriya* for him.

Although the book is being published after a decade since the write-ups of the first manuscript no major changes are made to the original English script in order to maintain the integrity of the book with that of the mind-set of the author.

M. Enamul Hamid
Richardson, TX, USA
September 2009

ABOUT THE BOOK

I had always been 'interested' about Islamic Economics, but had never had the opportunity to study it with the seriousness and rigour it required. This opportunity was created by the Department of Economics, Rajshahi University, when it accepted my proposal of introducing Islamic Economics as one of the optional papers at the Master's level, encouraged me to prepare the syllabus, write a text-book, and at the same time bear the responsibility of teaching the course. This was, beyond the imagination of my colleagues, was a Herculean task for me. In the true sense of the term, there was no text-book on the subject. The materials I had with me or in the Rajshahi University library were too inadequate and dispersed for the preparation of a syllabus, not to speak of writing a book. I contacted the Islamic Research and Training Institute, IDB, Jeddah and got some materials, but again, these were prepared on specific topics. I did not leave the steering. I made a draft syllabus, started reading the materials and compiling bits and pieces from different sources. In the mean time, I got an invitation from the International Islamic University Malaysia to write a paper on Islamic Economics. In a sense this provided me further incentive to go deep into the subject. At this time I also started teaching the course. Thirty six students took the course. Some of the students were very critical about the concepts and explanations of some of the issues I presented before them. Sometimes I talked to my colleagues, Islamic scholars and others, and had their reactions about some of the ideas I decided to put in the text. My son's insistence to visit them in the USA and have access to internet facilities, and granting of six months' sabbatical leave by the Rajshahi University provided me further opportunity to collect new materials on the subject.

The book is the result of my extensive reading the Islamic economics literature and one year teaching. I do not claim any original contribution in making the book. What is done ultimately boils down to collection, compilation, assimilation, elaboration, summarisation, addition and subtraction of the materials found in the literature. I have

dedicated the book to the Islamic Economists, particularly to those whose writings I have come across very frequently. The areas in which their (Islamic economists in general) names appear reflect their ideas, but for any 'mistake' committed while making additions or subtractions or even giving new interpretations, the author alone remains personally responsible.

The book is divided into 8 parts having 22 chapters in total. Part I, introductory, contains two chapters. First chapter strives to present the reasons for believing Islamic Economics as a new discipline. Chapter 2 deals with other introductory matters including definition, assumptions, principles, and natural and scope of Islamic Economics. Part II is microeconomics and comprises as many as 5 chapters. These are Theory of Islamic Consumer Behaviour, Islamic Theory of Demand and Supply, Towards a Theory of Islamic Firm, Factors of Production and Their Pricing, and Market Structure in an Islamic Perspective. Macroeconomics is given in Part III. There are two chapters in this part, i.e. Theory of Islamic Consumption Functions, and Savings and Investment Behaviour in Islam. Part IV presents money and banking. Money is discussed in one chapter, while banking is divided into two – Islamic Banking in Theory, and Islamic Banking in Practice. Public Finance is presented in a separate part (Part V). There are three chapters, one deals with the Islamic finance of the past and present, one deals with the role of *Zakat* and the last one deals with the role of taxation. Part VI exhibits international trade. It deals with co-operation among Muslim countries. In Part VII is presented as many as four chapters relating to economic development in Islam. Goals and strategies of development in an Islamic perspective are discussed in another chapter. Still another chapter is written on the mobilisation of resources for Islamic economic development. The case of women in Islamic economic development is given a separate treatment: a new chapter is devoted to it. The last chapter of this part is entitled as 'The Islamic Worldview and the Islamic Responses to the Third World Socio-economic Problems'. This is perhaps the most important chapter of the whole book. It analyses the economic responses to the socio-economic problems facing the third world countries in an Islamic perspective. An appendix is added as 'Concluding Remarks'. This, in effect,

reflects my reactions to some of the severest attacks made in the literature against the Islamic economics. This is entitled 'Today's Problems and Tomorrow's Solutions: The Future of Islamic Economics'. For the benefit of the teachers and students, model questions on each chapter have been appended.

All readers may not be interested or have time to go through all the chapters of the book. A guideline is therefore given as:

> **If you are a student:** the book is actually written for you. You are expected to read chapters 2 through 21. You may not try to read the first and the last chapters at the first stage.
>
> **If you are conversant with Islam and want to have some idea about Islamic Economics:** you should read at least last chapters.
>
> **If you do not feel at home with Islamic Economics:** you would enjoy, I am sure, reading at least the first and last chapters.

I prepared the book in English. My colleague, Professor Shah Muhammad Habibur Rahman, translated the book into Bengali. With his very extensive writing habit and appreciable knowledge in Islamic literature, while translating, he has incorporated his own ideas in some places with my consent. This help and co-operation cannot be compensated for either by giving thanks or by money. The only thing I wish to do is to acknowledge this act of scholarly assistance and pray for his prosperity and long life in this material world and pray for his eternal peace and happiness for the life Hereafter.

While preparing the book, I have had the help and co-operation from many persons and institutions. To name them one by one would take me beyond the scope of this book. Very briefly, I would like to express my sincere thanks: to IRTI, IDB, Jeddah, for sending the materials I wanted very quickly by air; to the Islamic Economics Research Bureau, Islamic Bank Training Academy, the International Institute of Islamic Thought, Bangladesh Bank, all at Dhaka, for providing me the opportunity and facilities for using their libraries; and to my colleagues of the Department of Economics and the Vice Chancellor (Professor M.A. Khaleque), Rajshahi University for granting me the necessary leave. To this, I must add the co-operation and assistance I received from my sons: M. Ekramul Hamid,

Lecturer in Computer Science, RU for helping me learn the necessary computer skills and in overcoming many complications I faced in preparing the materials, while in USA, M. Enamul Hamid, Engineer, Texas Instruments, USA, for providing me the internet facilities along with collection of materials for the preparation of the Book, M. Ehsanul Hamid, Master's student in Computer Science, USA and his wife Najme Mohsena, Master's student in Electrical Engineering USA, for their help in finding relevant materials from different sources in the USA. It would be too unkind if I do not record the material and untiring co-operation I received from my wife, Ayesha Hamid, my daughter-in-law, Ripi and Simi and above all my mother. My two-year old grandson Fahad and five-year old grand daughter Fariha were very often kind enough to allow me to use the computer keys rather 'freely'.

I consider myself to be extremely lucky to have become able to convince Dr. M.A. Mannan, one of the pioneers in the field of Islamic Economics, presently acting as the founder Chairman of the Social Investment Bank Ltd., Bangladesh, to write the Forward of the Bengali edition of the book. I express my sincere gratitude to him and pray his long and prosperous life.

This is the first edition of the book. It is highly likely that it contains, in addition to printing errors, many unintended conceptual mistakes. I appeal to all conscientious readers to point them out and inform me either directly (by letters) or through discussion in the papers and articles. All meaningful comments and suggestions will be duly acknowledged in the next edition of the book. Let us remember one authentic *Hadith*:

'The best *Sadaqa* is to learn a point of knowledge (*ilim*) and teach it to your Muslim brothers'. **(Ibn Majah)**

July, 1999
Rabial-Awal, 1420

M.A. Hamid
Rajshahi University
Bangladesh

GLOSSARY OF ARABIC TERMS

Adl	: Justice
Alim	: Scholar
Amanah	: Trust
Fard Ayin	: Personal obligation of every Muslim
Fard Kifayah	: Collective duty of the Muslim society
Fiqh	: Islamic jurisprudence
Bai	: Stands for sale
Bai Muajjal	: Sale against deferred payment, either in lump sum or in instalments
Bay Salam	: Advance sale. Here, the Bank makes the advance payment for the goods to be delivered by the clients at some future date
Halal	: Anything permitted by the *Shariah*
Hadiths	: Sayings of the Prophet (pbuh)
Haram	: Anything prohibited by the *Shariah*
Ibadah	: Worship. In its wider sense, it means living in conformity with Islamic teachings
Ijma	: Consensus of Islamic scholars on a point of Islamic law
Ijtihad	: The logical deduction on a legal or theological question by the learned
Khalifa	: Vicegerent
Mudaraba	: It is an arrangement in which one party invests capital and another party trades with it on the understanding that they share the profits in an agreed upon ratio, and that any loss resulting from normal trading activity is borne by the investing party
Murabaha	: Resale of goods with the addition of a fixed surcharge to the sated original cost
Musharaka	: Means partnership. There are two partners- the financial and the entrepreneurs. They agree to contribute their mutually agreed share to their capital and labour required for operating the business, share profit in an agreed ratio and share

	loss in the proportion of their capital employed in the business.
Nisab	: The minimum number, quantity or amount of wealth the possession of which make the assessees liable to pay *Zakat*
Qard Hasan	: Benevolent loan without interest
Qiyas	: The analogical reasoning of the learned with regard to the teachings of the *Quran*, *Hadiths* and *Ijma*
Quran	: The Holy Book of the Muslims consisting of the revelations made by Allah to the Prophet Muhammad (pbuh).
Riba	: Literally means increase or addition and refers to 'premium' that must be paid by the borrowers to the lender along with the principal amount as a condition for the loan.
Sadaqa	: Voluntary alms
Salat	: Obligatory prayers 5 times a day
Shariah	: Islamic jurisprudence; laws of Islam as given by the Quran and the Sunnah
Sunnah	: The tradition which records either the sayings or doings of the Prophet (pbuh)
Shura	: Mutual consultation
Surah	: A Chapter of the Quran
Tawhid	: Oneness and unity of Allah
Ummah	: Refers to the whole Muslim community, irrespective of colour, race, language or nationality, which carry no weight in Islam
Ushr	: Ten per cent of agricultural produce payable by a Muslim as a part of his religious obligation, like *Zakat*, mainly for the benefit of the poor and the needy
Zakat	: Due of the poor payable by the solvent Muslims (regular charity)
Zulm	: A comprehensive term used to all forms of inequity, injustice, exploitation and wrong-doings.

PART - I

INTRODUCTORY

'SURELY, THE RELIGION BEFORE ALLAH IS ISLAM (SUBMISSION TO HIS WILL)' [AL-IMRAN 3:19]

Chapter 1

ISLAMIC ECONOMICS: WHY SHOULD WE STUDY AT ALL?

(Twenty Seven Reasons for Believing in Islamic Economics)

Many social scientists trained in Western education system (like me) have some sympathy for Islam as a religion, but can not believe that a separate discipline can very well emerge out of it. This introductory book begins with explaining the reasons for believing and studying Islamic economics. It is conceived that if any one of the given twenty seven reasons attracts any reader he or she can not but have interest in the study of the subject.

1. Opinion of Sen-Yunus plus Constitutional Obligation

The 1998 Nobel Laureate Amartya Sen[1] believes that the conventional economics that we read and teach today can not ensure **Human Welfare** in its truest sense and another expected to be Nobel Laureate Muhammad Yunus (He received it in 2006 for peace) urges that for a poverty-free world we must write NEW economics text-books. The Bangladesh Constitution directs us that all our actions must be based on the absolute trust and faith in the Almighty Allah. The new discipline that we call 'Islamic Economics' is one of the manifestations of these messages. Therefore, it should be of common interest to see and study its contents.

2. The Fundamental Economic Problems and the Case for Revealed Knowledge

The fundamental economic problems are WHAT to produce, HOW to produce and FOR WHOM to produce. In the capitalistic

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[1] In one of his earlier studies, he concludes: economics 'can be made more productive by paying greater and more explicit attention to ethical considerations that shaped human behaviour and judgement" (Sen 1989, p.9).

society, the answers to these problems are sought through the market mechanism (invisible hands), and in the socialistic society, the solutions are dictated by the state. Neither of these systems (at least not the second one) has been able to offer satisfactory solutions to the basic socio-economic and political problems facing the modern world. In Islamic economics, the solutions are sought from the knowledge of the Quran, *Sunnah* (these two together sometimes called **Revealed Knowledge)**, *Ijmah* and *Ijtihad*. The inquisitive readers would obviously be interested to see whether the latter can offer any better mechanism for the solution of the problems under review. It should be understood that the Revealed Knowledge is not meant for the Muslims only, rather, it is for the benefit of the whole mankind, irrespective age, sex, colour and sect. Islamic economics can profitably be read by all those who believe in economic injunctions of the Islamic *Shariah.*

3. The Young New Discipline

Conventional economics has come to the present state through several stages over, perhaps, more than few hundred years. Islamic economics discipline is relatively very young. At its early stage, the Quranic injunctions along with the relevant Traditions of the Prophet were considered as the literature of Islamic economics. The real work on Islamic economics, as a new discipline, actually started only from the forties of the last century. The work has gone far, although not too far, within this relatively very short span of time. The inquisitive social scientists, and others having interest in the subject, would certainly be interested to see the development of this new discipline.

4. The Way of Balanced Development of Material and Spiritual Life

All the three social systems, as mentioned above, aim to achieve human welfare, but they differ when its composition is considered. The socialistic system is satisfied with only material welfare. The capitalistic system is not, in the true sense of the term, satisfied with this: it also strives to achieve spiritual satisfaction. But the mechanism (complete freedom) through which it wants to achieve is anything but asocial. It is Islam, which gives equal importance to both the material and spiritual welfare of the human beings and strives

to materialise through appropriate activities. It puts emphasis on not only the balance between extravagance and niggardliness in consumption or balanced production between different regions but also balance between the material life and spiritual life.[2] In effect, it would be interesting to see how Islamic economics ensures both these types of satisfactions simultaneously.

5. Application of Dual Accountability

In the socialistic system, people are accountable to none but the state for their actions. In the capitalistic system, people are also accountable, but not to the state, but to themselves. In the Islamic society, people are accountable not only to themselves (their families) but also to the society they belong to. The latter is technically called 'Dual Accountability'. In other words, all people are accountable to Allah for each and every actions they perform in their life. This notion of dual accountability is a prerequisite for ensuring equitable distribution of income and wealth in the society. The study of Islamic economics, therefore, can not be neglected.

6. The World of Equal Human Dignity

Islamic economics, contrary to normal belief, believes that all individuals are equal in their human dignity. These 'all individuals' include all <u>men</u> and <u>women</u> irrespective of their ages, races and regions. Islamic economics teaches that everybody must be given the opportunity to earn according to his/her capacity and that all the poor and needy persons must be provided with the basic or essential needs, defined as such in a particular social context. He who respects this view can not but sympathise this discipline and makes efforts to make improvement upon it.

7. 'Islamic Rationality' as Against 'Economic Rationality'

In Islamic economics, 'Economic rationality', which is guided by self-interest, is replaced by 'Islamic rationality', which is guided by

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[2] In Islamic economics, 'success' is defined as success not only in the accumulation of wealth but also success in the attainment of mental peace.

Islamic norms. The term 'Want' which is unlimited, is replaced by 'Need', which is limited. An Islamic consumer always tries to satisfy his needs, and not wants. Definitely, from this perspective, the nature and scope of Islamic economics would be different from those of conventional economy, and, therefore, would require a separate study.

8. Consumer Sovereignty Guaranteed within Islamic Norms

In capitalistic society, an individual consumer is assumed to have complete freedom in the matters of choice of goods and services he or she would consume. That means that his sovereignty is guaranteed. He chooses that commodity or combination of commodities that gives him maximum satisfaction. The socialistic system completely ignores this consumer's freedom. In this system, he, in a sense, is the slave of his Masters. Islamic economics disapproves both these viewpoints. Here, his sovereignty is guaranteed under the guidance of the Islamic norms. He is not allowed to consume any *Haram* (prohibited) commodities and is also not sanctioned to consume as much as his income permits when his neighbour (for example) goes hungry. Technically speaking, he spends not only for this material world but also for the world to come (Hereafter). Anybody who believes in the life Hereafter would be interested to see how this type of consumer should behave in the actual world. This means that the study of Islamic economics would be interesting.

9. Producer's Sovereignty Guaranteed within Islamic Norms

The individual producer in the socialistic society has no freedom in the matters of the choice of commodity and the quantity to be produced. The capitalistic society gives him complete freedom. He produces that commodity or combination of commodities that gives him maximum profit. More technically, his sovereignty is assured. Islam rejects both these systems. Here, the individual producer has freedom but within the boundary of the *Shariah.* A true Islamic producer will not produce any prohibited goods or services. He does not necessarily try to achieve maximum profit; rather he produces that

commodity or a commodity that brings his maximum satisfaction both in this world and in the world Hereafter. Should we intend to see how it is done, we should study nothing but Islamic economics.

10. Administering the Universally Accepted Maxim: Meet Essentials First Before Luxuries

In the conventional economics, distinction is made between different levels of consumption like necessities and luxuries but no efforts are made to frame appropriate policy to implement them. In an Islamic society, it is essential for all individuals as consumers and producers as well as for the government to remember the distinction while making decisions. It is imperative that the demand for essentials is met first and then attempts are made to meet relatively non-essential needs. In effect, an Islamic state is not allowed to raise taxation or to resort to borrowing until all the basic needs of the types of people living in the country are satisfied. Anybody that concerned about the well being of the whole mankind can not normally ignore the study of Islamic economics.

11. Islam: Not an Obstacle to Economic Development

One popular belief is that Islam stands as an obstacle to economic development. This belief appears to be nurtured by not only by the secular social scientists in general but also by some religious scholars in particular. The truth is far from this. The interested scholars can themselves find out the truth by an in depth study of Islamic economics.

12. New Concept of Economic Development

In conventional economics, development is viewed as the development of material well being of the man. The concept of economic development in Islamic economics is much wider. It considers the development of man in its totality. This 'development' embraces life both in the earth and in the Hereafter. Consequently, in the list of determinants of economic development it gives as much importance to the socio-moral factors as the traditional economic ones.

13. Energizing the Hitherto Neglected Non-Economic Factors Including the Cultural Ones

The origin of economics is primarily found to be in ethics. The original makers like (as back as) Aristotle (384-322 B.C.) or (more recent) Adam Smith (1723-1790) were moral philosophers. They gave due importance to cultural factors. Later the modern reformers like Marshal found it difficult to incorporate the non-economic factors in the economic analysis. Ultimately, they were, in a sense, thrown away in the basket of *ceteris paribus* (other things remaining equal). This treatment is certainly not practical. In the real world situations, non-factors sometimes become more prominent than economic factors It is Islamic economics in which attempt is again being made to integrate economic, social and moral values in the consumption, production and distribution activities. The scope of Islamic economics is naturally wider than that of conventional economics. It should therefore be of anybody's interest to study this discipline and see the application of non-economics factors including the cultural ones.

14. Growth with Equity: How?

In the socialistic society, equity in the distribution of resources is the primary concern, growth of the economy is secondary. The capitalistic society believes that if growth is achieved, equity will come automatically. Experience shows that both these systems have failed to ensure growth and equity. In Islamic economics, the concern is not between growth or equity, but how to achieve both simultaneously. It would be obviously interesting to see how these twin objectives are materialised.

15. Built-in Motivational Mechanism for Ensuring Full Utilisation of All Resources

Efficient and full utilisation of resources are a precondition for success in any development effort. Islamic economics has a built-in motivational mechanism for ensuring this. In Islam, all resources are taken as Allah-given. He (Allah) is the absolute owner of everything. Human beings are a trusty of these resources. As a trusty, he has no

authority to misutilise or underutilise these resources. Wastage is condemned in Islam. Once this Islamic concept is accepted, and appropriate policies are framed and implemented, the limited resources available at the disposal of the people would become fully utilised. All inquisitive social scientists would certainly like to see how this is done through the implementation of the principles of Islamic economics.

16. Built-in Mechanism for Encouraging Productive Investment

In all societies capital formation is regarded as the life-blood of economic development. Islam has a built-in mechanism for encouraging investment. One obvious way through which this can be effectuated is the institution of *Zakat*. If the accumulated wealth is kept idle, the *Zakat* will erode it below the *Nisab*. Therefore, a true Muslim, in order to prevent the amount of wealth from falling, would invest it for productive purposes so that it becomes possible for him to pay *Zakat* out of his increased income rather than on the existing one. Therefore, under Islamic economic system, it is possible to have a higher rate of growth (with of course, justice) due to its emphasis on productive investment.

17. Call for 'No More Begging' But 'Become Self-Reliant'

Contrary to popular belief, Islam calls for 'No more begging but become self-reliant'. People may beg only under compelling circumstances. All able-bodied persons are required to try to earn their livelihood through legal means. They are even discouraged to keep themselves all the time within the four walls of the mosque forgetting their obligation to the family. If these messages were popularised, this would certainly go a long way to widen the scope of economic activities within the Muslim societies. However, without the study of Islamic economics, this would remain simply a dream.

18. Preference on Self Employment Over Wage Employment

The poor people can be helped by giving 'wage-employment' and creating opportunities for 'self-employment'. Both these strategies

are in vogue in the traditional system. Although Islamic economics follows suit, it appears to give much more importance on the latter than the former. Even *Zakat* funds are urged to be used not merely for making temporary help to the poor but to help them stand on their own legs. It should of crucial importance how the Islamic strategies are administered to create self-employment for the unemployed and underemployed people.

19. Ensuring Economic Rights of the Women

Quite contrary to general beliefs (including even some of the Islamic preachers), Islam gives almost equal importance to women in the matters of participation in economic activities. They can, within the limits of *Shariah,* take part in economic activities and hence can make important contribution to general economic development. Only thing that is required is to place them in appropriate field. The Islamic women have defined economic rights. The concerned social scientists would certainly like to know more about this. It is only the study of Islamic economics, which can provide them the necessary knowledge as to how to ensure economic rights of the women in general and Islamic women in particular.

20. Practising Banking without *Riba* (or Interest)

In conventional economics, the field of money and banking, 'interest' is given an omnipotent role in the matters of allocation of resources. This institution (in Islamic terminology, *Riba)* is prohibited in Islam because of its, among others, exploitative character. It was normally believed that the modern economy can not run without this mechanism. This apprehension has now been foiled by the establishment of growing number of Islamic banks not only in the Muslim countries but also in the non-Muslim ones. At least for the sake of professional interest, it would be necessary to see how the Islamic banking system is working side by side the conventional banking system and is doing in many cases better than its counterparts.

21. Availability of Financial Instruments for Replacing Interest

To replace interest, a large number of financial instruments have already been developed in the Islamic economic literature. Many

of them are now being successfully employed in mobilising funds and allocating them for productive purposes. These mechanisms have been proved not only efficient but also equitable. Let us see through the study of Islamic economics what these mechanisms are and how they are working.

22. Creating Environment for the State to Play it's Progressive but Humane Role

In the socialistic society, state plays the dominant role, the general people are simply to obey. In the capitalistic society, the state makes the least interference in the matters of the socio-economic management of the country. In the Islamic society, the state neither becomes the Master, nor leaves everything in the hands of the individuals. Its role in the economy is active and crucial. Its role is active in the sense that while giving freedom to the economic agents, it oversees whether there is violation of the principles of the Islamic economics. Its role is vital in the sense that it performs those activities, which are not normally done, or can not be done, by the individual persons. To defend the country from external aggression, to maintain law and order in the country, to make provisions for the poor and needy, are some of the examples in point. The study of Islamic economics provides detailed insights about these and helps create an environment for the state to play its progressive but humane role.

23. Prudent Integration of Taxation and *Zakat* as a Source of Development Finance

Taxation is used as the most dominant source of revenue in the modern economy. Given the ways it is utilised, there remains little scope for utilising the funds thus collected specifically for the interest of the poor. Islam, while recognising the importance of taxes as sources of government revenue, has a built-in mechanism for helping the poor and needy. This is done through the collection and distribution of *Zakat*, a compulsory payment by the solvent Muslims to the poor. The administration of *Zakat* and its integration with taxation require a lot of study and research. Islamic economics fulfils this requirement.

24. Creating Atmosphere for a Corruption Free Society

In the conventional economic environment, the businessmen resort to hoarding essential goods during the time of crisis just to derive the advantage of sky-high prices. This is definitely done at the cost of the general masses. There are other corrupt practices including cheating, false advertisement and lying about one's merchandise. Islamic economic system forbids these plays of the people and urges them not to keep the essential goods for more than forty days during the period of crisis and avoid other corrupt practices. Introduction and the study of Islamic economics would inculcate this philosophy in the minds of its readers and hence help create an atmosphere free from corrupt practices in the society.

25. Activate the Co-operative Spirit among the Muslim Countries

Speaking globally, there are presently 54 Islamic countries comprising about 20 per cent of the total world population. Apparently, these countries should have become world force not only economically but also politically. The reality is, however, far from this. From economic viewpoint, as many as 43% of the total population of these countries fall within 'Least Developed Countries' and only 2% of them fall within 'High Income Countries'. The rest of the countries are within these two groups. Politically speaking, most of them appear to have forgotten their self-speaking capability. This should not have been the picture. These countries together produce about 66% of the world's crude oil, 70% of natural rubber, 40% of jute, 50% of palm oil, 80% of kopek, 90% of cinchona, and huge number of skilled and unskilled manpower. What is needed is co-operation among these countries with the aim of achieving overall well being of the people living in these countries. In order to materialise this objective, it would be required to make an intensive study and research. Islamic economics can provide a good forum for this.

26. A Forum for Interaction between Conventional Economists and Religious Scholars

Conventional economists and religious scholars (*Ulama*) are living in two different worlds. The former, having trained in the Western economic system believe that whatever they are reading, teaching and practising are right. The *Ulama*s are trying to take the

economy back to the old days of the sixth or the seventh century A.D. The Islamic scholars, on the other hand, having trained in the Quran and *Hadiths* believe that whatever they are reading, teaching and practising are right. The traditional economists are all committing sins. The socio-economic turmoil that we find in the today's society are the results of their wrong policies. Interestingly, the education system that we have in most of the Muslim countries is such that both these beliefs are being nurtured quite uninterruptedly behind many persons' reflections.

What is true is that 'Our *Ulama* see only a part of it and the modern educated persons see another part of it. Both remain prisoners to a different type of education and training. Our two eyes unfortunately do not focus at the same point. If both eyes do not focus on a particular point then we have blurred vision'.[3]

The study of Islamic economics can create a forum in which the conventional economists having interest in Islam and the Islamic scholars having interest in the socio-economic affairs of the society can interact. This interaction and feedback is extremely important for the future of Islamic economics.

27. Tracking with the Historical Development with the Growing Islamic Economics as a New Discipline

The last forty years has witnessed serious theoretical works on Islamic Economics, Finance and Banking and institutional development for their implementation. For instance:

- establishment of the OIC (Organisation of Islamic Conference) of 54 Islamic countries of the world along with a large number of specialised and subsidiary organs;
- creation of the IDB (Islamic Development Bank) in which 51 Islamic countries have so far became members, along with its other affiliated institutions;
- introduction of continuously increasing number of Islamic financial institutions (including Islamic banks) in both Muslim and non-Muslim countries, total number exceeding 300 marks;

[3] See question-answer session, Khurshid Ahmad (1992, p.47)

- the enthusiasm and interest being shown by the 'Western conventional banks' including some multi-national giants, such as the World Bank and the International Monetary Fund;
- setting up of Islamic Chamber and Commerce, Industry and Commodity Exchange (and host of other similar institutions);
- launching of Islamic Equity Index aiming at investors who follow Islamic investment guidelines (e.g. Dow Jones Islamic Market Index or DJIMI, introduced by Dow Jones and Co. , the publisher of the Wall Street Journal and Interactive Journal covering 600 companies of 30 countries including the USA;
- recognition of Islamic economics teaching and research by the renowned educational institutions of the world, creation of Chair in Islamic Economics (e.g. Rice University, USA; King Faisal Professor of Economics in the University of Southern California), and so on.
- establishment of 'Harvard University Forum on Islamic Finance' in Harvard University, USA.
- introduction of Islamic Finance and Investment Practices in Law Firms (e.g. The King and Spalding – K&S- one of the top forty law firms in the USA, 'in recognition of the continued growth of Islamic financial institution and their specialised legal needs'); and
- specialisation in Islamic Economics and Finance by world renowned non-Muslim economist (e.g. Professor Rodney Wilson of the University of Durham (UK) and Professor John Presley (UK)); and above all,
- the call for establishment of an Islamic Common Market, Islamic Monetary System, and Islamic Dinar by the Islamic world.

If these historical developments are combined with the reasons as explained above, to my understanding, the conscientious social scientists, including those who have hitherto been apathetic, cannot but study the new discipline, Islamic Economics.

Chapter 2

ISLAMIC ECONOMICS: WHAT AND WHY?

[**Key Concepts:** The Quran – The Revealed Knowledge – The *Sunnah* – The *Hadiths* - *Ijma* – *Ijtihad* – *Qiyas* – *Fiqh* - *Fiqh-al-Ibadah* - *Fiqh-al-Muamalat* - Islamic *Shariah* - composite social science – integration of economic, social and moral values - Allah's sovereignty – Islamic Economic Man – dual accountability – Hereafter – ideological obligations - positive economics – normative economics]

1. SOURCES OF ISLAMIC ECONOMICS KNOWLEDGE

Initiation: Any society, be it Socialistic, Capitalistic or Islamic, must somehow confront three fundamental economic problems. <u>One</u>, **WHAT** goods and services shall be produced and in what quantities? Food or luxury household items like refrigerator and television? Much rice and little jute, or vice versa? Much juice from date palm for producing molasses or for producing alcohol? All these for today or tomorrow? <u>Two</u>, **HOW** shall these goods be produced? That is, by whom and what resources and in what technological manner are they to be produced? Who produces food, who produces clothing? Electricity from stream or from atom? <u>Three</u>, **FOR WHOM** shall these goods and services be produced? Or, how the total national income is distributed among different individuals and families, and among different regions? A few rich and many poor? Or most people in reasonable standard of living?

Interestingly, although the Socialistic, Capitalistic and Islamic societies face these common questions but they come out with uncommon answers. This is simply due to the fact that the sources of knowledge on which these societies base their answers are different. The Socialistic society bases the answers on the knowledge as provided by the State. There, the individual persons have very little to

say regarding the answers to the above questions. It is the State, which actually dictates as to what to produce, how to produce and for whom to produce. In the Capitalist society, the answers are sought from the market. It is the system of price that actually governs the economic behaviour of the people. Here, the people as producers, as distributors and as consumers are assumed to be sovereign. They are assumed to be highly rational and have the capability to decide correctly what is good and what is not.

In Islamic society, limitation of human knowledge is acknowledged. The Quran says, '**Say: The Spirit (cometh) by command of my Lord: of knowledge it is only a little that is communicated to you, (O men!)'[Bani Israil 17:85].**[1] The Islamic society, however, does not make absolute reliance either on the State or on the individual persons for the answers posed above. In Islam, there are well-defined sources of knowledge from which the answers of the questions are sought. These sources are both static and dynamic, rigid and flexible. There are four sources namely, (a) The Quran, (b) The *Sunnah* or *Hadith,* (c) *Ijmah*, and (d) *Ijtihad* or *Qiyas.* All these sources are explained as under.

(a) The Quran

The Quran is the Holy Book of the Muslims. This is the Word of Allah. It was revealed through the Angel Gabriel to the Prophet Muhammad (peace be upon him)[2], and hence often called the 'Revealed Knowledge', during his Prophethood of about 23 years. Originally, the Divine guidance was orally conveyed to the people among whom the Prophet lived. As human civilization advanced and people began to read and write, the Divine revelations were written

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[1] All quotations from the Quran are given within third brackets. For identification, the sequence is: name of the *Sura* (here, **Bani Israil**), the *Sura* number (here, 17) and the *Ayat* number (here, 85). For all quotations, this sequence will be maintained throughout the text.

[2] As stated in 'the Apology', the salutation 'pbuh' is to be understood: it will not be repeated from now on.

down as and when received. The Book is addressed to the entire human race transcending all barriers of race, region or time. It lays down the fundamentals of the Muslim faith, including all aspects of the Islamic way of life. As the Quran itself says, **'Surely, the Religion before Allah is Islam (submission to His Will)' [Al-Imran 3:19].** Or, **'This is the Book; in it is guidance sure, without doubt, to those who fear Allah' [Baqara 2:2].** The Quran consists of 30 parts (usually called *Paras),* 114 chapters (called *Suras*), 6,666 verses (known as *Ayats).*[3]

In verse 7 of the *Sura* Al-Imaran **[Al-Imran 3:7]**, three types of Supreme Decisions are given.[4] First, in this verse the Quran categorises those acts that it unequivocally recommends as good acts (e.g., social justice, practice of trade, distributive equity). Second, it categorises those acts which it unequivocally condemns as bad acts (e.g., alcoholic drinking, *Riba* in financial transactions, wasteful consumption and production). Third, it leaves certain borderline cases for judgement by the Islamic community and the individuals on the basis of their primary sources of the *Shariah* laws (e.g., phasing out of interest-free society, limits of property rights, the permissible mix of basic needs, comforts and luxury goods allowed to the individual and to the society).

For all aspects of Islamic economics, this Quran is regarded as the first hand knowledge. The basic principles of the behaviour of the economic agents – producers, distributors and consumers – are all drawn from the Quran. It serves as the basis for making distinctions between permitted (*Halal*) and prohibited (*Haram*) goods and services. More importantly, the other sources of knowledge as described below, uses the Quranic injunctions as the starting points.

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[3] The *Ayat* number may vary depending upon how one treats certain grammatical laws.

[4] The verse is **'He it is Who has sent down to you the Book: in it are verses basic or fundamental (pointing categorically to good and bad (of established meaning). They are the foundation of the Book: others are allegorical'.**

For writing this textbook, excessive reliance would be put on the various principles as contained in this Divine Book.

(b) The *Sunnah* or *Hadiths*

Literally, the *Sunnah* means the practices of the Prophet, whilst *Hadith* means the 'tale or news'. In Islamic terminology, the term *Sunnah* refers to all the practices and doings of the Prophet; but the *Hadith* includes the sayings, the doings and the implicit approvals of the Prophet. This textbook will not, however, make any such distinction between the two; rather these two terms will be used interchangeably.

After the Quran, the *Sunnah* is the most important source of Islamic knowledge. These are known through the collection of the *Hadiths*. In a sense, *Hadith* is the interpretations of the Quran by the Prophet. The Muslims have naturally been directed to abide by his advice. As the Quran says, **'O ye who believe, obey Allah and obey His Messenger and those who are in authority among you. Then if ye differ in anything, refer it to Allah and His Messenger, if ye are believers in Allah and the Last Day. That is the best and most commendable in the end' [Nisa 4:59].** This had to be so for obvious reasons. The Quran left many matters to be regulated by the Prophet. For instance, it declared *Zakat* to be compulsory for all Muslims but nowhere in it was explained who would have to pay *Zakat* and by how much. It was the Prophet who actually prescribed and illustrated the application of *Zakat* in the society. Similar is the case with *Riba*. The Quran is completely silent about the meaning of *Riba,* its different forms, the reasons for its prohibition, and other similar aspects. It is the *Hadiths* of the Prophet (along with other sources) which actually provide the various explanations required. The Islamic economists also derive a large body of knowledge from the *Sunnah*. The matters pertaining to the theory of ownership, theory of wealth, production and reward of factors of production, the problems of consumption and market mechanism, etc. heavily depend upon the *Hadiths* of the Prophet.

The most authentic sources of the *Hadiths* of the Prophet are popularly known as the *Siha Sitta*, i.e., the six Authentic Compilations. These are the *Sahih* **Bukhari, Muslim, Tirmidi, Abu Daud, Nasai and Ibne Majah.**

(c) *Ijma*

Ijma is the third source of Islamic knowledge and hence it can be used for making Islamic economics too. This source of knowledge actually owes its origin to the Quran and the *Sunnah.* As the Quran says Allah bestows sustenance on those **'who (conduct) their affairs by mutual consultations' [Shura 42:38].** Technically, it refers to the consensus of the Islamic scholars on the issue(s) regarding which no specific solution(s) can be obtained either from the Quran or from the *Hadith.* The distinction between the *Hadith* and *Ijma* is that the knowledge derived from the former is limited within the teachings of the Prophet in his lifetime and his Companions and that of the later goes beyond (and up to the Day of Resurrection). Another distinction is that the former is the 'words and works' of the Prophet, in contrast the latter is the 'words and works' of the *Mujtahids* (doctors of law qualified for *Ijtihad*).

In the case of the Quran, the question of consensus was irrelevant since the Prophet used to recite the *Suras* in the order as found in the Quran, and not in the order of sequence in which those were revealed, and his successors accepted and followed the same order without any question. However, in the case of the *Hadith* literature, it was tremendously hard work requiring skill, knowledge and logical reasoning so that true traditions could be distinguished and sifted from all available statements and narrations. These required consultations, reasoning and testing with reference to the available sources of personal and other evidences. It is in this sense that the *Ijma* is regarded as an important source of knowledge of Islamic law.

It may be noted that if all the learned Islamic scholars agreed on a certain issue, the opinion becomes binding on the part of the Muslims. For example, although not found either in the Quran or in

the *Sunnah,* all the 'Muslim jurists have unanimously held the view that the welfare of the people and relief of their hardships is the basic objective of the *Shariah'* (Chapra 1985, p. 35). Again, if the Islamic scholars through discussion come to the consensus that cigarette cannot be produced in an Islamic society, then it would become obligatory for all concerned not to produce this commodity.

(d) *Ijtihad* or *Qiyas*

It is sometimes very difficult to see that all Islamic scholars of a society arrive at a consensus; on many issues, they differ in their opinions. There is nothing to be worried about these likely events, however. As one *Hadith* says, 'The difference of opinion in my Community is an indication of Allah's grace'. *Ijtihad* meaning research plays a very important role as a source of new information in this changing world. This source relies partly on the interpretation process and partly on the analogical reasoning process, and hence opens the door for new interpretation in the light of sources of knowledge as described above. It should be borne in mind that since it relates to **research,** the results would be uncertain, either right or wrong. But this does not mean that in Islam, research *(Ijtihad)* is prohibited. See, what the *Hadith* of the Prophet says, 'While doing research if somebody obtains the right answer he gets **two** rewards *(Sawabs)*, but if he makes mistake still he gets **one**.'

In the Islamic law, *Ijtihad* is divided into two – *Ijma* and *Qiyas.* The former is done by a set of Islamic scholars and later may be done by a single or very few persons.

The word *Qiyas* refers to the analytical reasoning of the learned with regard to the teachings of the Quran, *Hadiths* and *Ijma.* A situation, which can not be analysed by an explicit decree, in the Quran, the *Sunnah* or it is not found in the *Ijma*, may be decided by a *Mujtahid* on the analogy (*qiyas*) of an existing decree similar to it. *Ijtihad* may be done on all economic problems that emerge and have no solution in the former three sources. The only condition that has to be fulfilled is that it has to be within the framework of the Islamic *Shariah* and be done by competent persons only.

During the reign of Umar (may Allah be pleased with him)[5], many examples of *Ijtihad* can be found. Among others, through *Ijtihad*, he changed the methods of the collection of *Zakat* and stopped distributing acquired land among the soldiers who participated in the holy war. Changed circumstances warrant him to take such steps. This *Qiyas* through *Ijtihad* can be a very important source of knowledge for making Islamic economic society in the modern but dynamic world.

One example of *Qiyas* may be given before leaving this section. In the Quran, it has been stated categorically that **'Strong drink and games of chance and idols and divining arrows are only an infamy of Satan's handiwork. Leave it aside in order that ye may succeed' [Maida 5:90].** This clearly means, among others, that gambling is harmful for 'Islamic economic man'[6]. From this one can clearly make *Qiyas* (**inference**) that Allah dislikes harmful economic transactions and activities. On the basis of this *Qiyas*, it may be stated that an Islamic government will disband all harmful activities and economic transactions in the society it governs.

Concluding remark: When one considers all the four sources of Islamic economics knowledge together, particularly, the last one, one may discover that Islamic economics is not very far away from the Western economics. Although, this may apparently appear to be so, there is one fundamental difference. This may be ascertained from the fact that 'the findings of *Ijtihad* or *Qiyas* MUST NOT contradict those derived from *Ijma*; and, in turn, the findings of *Ijma* MUST NOT contradict those derived from *Sahih Hadiths*; and, again, the findings of the *Hadiths* MUST NOT contradict the clear dictates of the Quran.' Thus the points of agreement between Islamic economics and conventional economics are likely to be very much greater than those of the disagreement. However, since in Islamic economics, each problem is examined in the light of the *Shariah* and it becomes possible to reconcile divergent views, the area of disagreement will be narrowed down by reliance on one agreed source, the *Shariah*.

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[5] As stated in the 'Apology', the Sahlahri 'may Allah be pleased with him' is to be understood : it will not be repeacted from now on.

[6] See below for explanation of the concept.

2. A NOTE ON ISLAMIC *SHARIAH* AND *FIQH*

Quranic injunctions can not be changed, it is universally known. Can 'Islamic *Shariah*' be changed? In Bangladesh, one confusion has been created by one 'prominent' feminine writer that although the Quranic injunctions can not be changed, the Islamic *Shariah* can be changed! Since in Islamic economics the words Quran, *Sunnah* and *Shariah* would come frequently it seems wiser to dispel with this type of confusion at the very beginning.

The '*Shariah*' is an Arabic word, meaning laws. In the world of Islamic sciences, *Shariah* is used in a special sense. It encompasses both the Quranic injunctions and the *Sahih Hadiths* of the Prophet. This is based on the Quranic verse, **'The apostle's duty is but to proclaim (the message) but Allah knoweth all that ye revealed and ye conceal'** [Al-Maida 5:99]. Thus the role of the Prophet is to convey the Will of Allah, and not to invent anything according to his own liking and disliking. Therefore, in this sense, <u>*Shariah* is unchanging, permanent and universal with respect to time and space</u>.

However, the above noted confusion might have arisen because of the frequent and sometimes indiscriminate use of the word *Fiqh* along with *Shariah* in the Islamic literature. Literally speaking, *Fiqh* and *Shariah* are not necessarily the same.[7] The word *Fiqh*, again an Arabic word, means Islamic jurisprudence or Islamic laws. By '*Fiqh*' or 'Islamic law', 'we mean the interpretations, the views and ideas given by the Muslim jurists as explanations for the Quran and *Sunnah*' (Hamid Hassan 1992, p.105). In other words, it refers to human understanding of the Divine injunctions revealed by Allah through His messenger Prophet Muhammad. <u>These understandings or explanations are not Divine, but are subject to change with time and place</u>.

Thus it may be concluded that when *Shariah* is used in the sense of the Quranic injunctions and the *Sahih Hadiths* it is

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[7] 'The word '*Fiqh*' is commonly used or referred to as Islamic *Shariah*. However, this view is not correct' (Hamid Hassan 1992, p.105).

unchanging with respect to time and space and when it refers to *Fiqh* it may be subject to changes with time and space.

It would be useful to add here that Muslim jurists have classified Islamic *Fiqh* (i.e. Islamic law) into various categories. The foremost among them is *Fiqh-al-Ibadah* and *Fiqh-al-Muamalat*. *Fiqh-al-Ibadah* means the jurisprudence of worship. It deals with the relation between the man and his Creator, Allah. It includes rules pertaining to prayer (*Salat*), fasting (*Sawm*), regular charity (*Zakat*), pilgrimage (*Hajj*) and other related matters. *Fiqh-al-Muamalat*, on the other hand, means jurisprudence of transaction on social dealings. It deals with the relation between man and man. It contains the doctrines, norms, laws, rules and regulations governing the dealings, transactions, contracts, and agreement between and man and concerning assets and property. Although some basic knowledge about the former (*Fiqh-al-Ibadah*) is necessary for all Muslim economists, Islamic economics is mostly concerned with the later (*Fiqh-al-Muamalat*). It should be pointed out that *Fiqh-al-Muamalat* provides us with the framework but that is not the whole story. Our task, as Islamic economists, begins after that.

3. WHAT IS ISLAMIC ECONOMICS?

'Islam', an Arabic word, means **surrender**, more categorically, surrender to the Will of Allah. It is a derivative of the root *salam,* meaning **peace**. This implies that one can achieve peace by surrendering to the Will of Allah. The 'Will of Allah' is not to be regarded as an invention of 'Islam' alone. It is universal and unchanging in that it incorporates the same truths revealed by Allah through the Prophets to the people of all times. What is claimed new in Islam is that it is not 'merely a set of beliefs, but a complete way of life'. This 'complete way of life' has two parts i.e. : (i) worshipping Allah by one's self, and (ii) worshipping Allah by doing good to the humanity.

'Economics' is usually defined as the theory of human behaviour relating to production, distribution and consumption of goods and services. Modified to suit the tenets of Islam, almost similar words can be used to describe Islamic Economics. Mannan, one of the pioneers in the field of Islamic Economics in his path-breaking book *Islamic Economics: Theory and Practice* published in 1970 has given a simple but very useful definition i.e. Islamic Economics is 'a social science which studies the economic problem of a people imbued with the values of Islam.' Later, in another book *The Making of Islamic Economic Society* published in 1984, he has modified this definition by adding, among others, 'composite' to 'social science' meaning that it includes not only economic but also social and moral values and by 'people' he means not only Muslims but also non-Muslims.

Khurshid Ahmed, the first Islamic economist to receive the IDB (Islamic Development Bank) Prize in 1988 for his contribution to the making of Islamic Economics, has defined it as 'a systematic effort to try to understand the economic problem and men's behavior in relation to that problem from an Islamic perspective' (K. Ahmed 1992, p.19). This definition also unfolds the basic philosophy of the subject.

It is possible to give a more comprehensive definition of Islamic Economics. After all, as said above, Islam is not merely a religion but a complete code of life and that human behaviour, or more precisely, human economic behaviour, is a subset of this code. In this light, Islamic Economics can be defined **as that part of Islamic code which studies, as a process, economic, social and moral human behaviour in an integrated manner in relation to production, distribution and consumption of goods and services.**

Four points can be noted from this definition:

<u>First,</u> Islamic Economics deals with only a part of Islamic code which is defined primarily in terms of the Quran, the *Sunnah*, and secondarily, by the *Ijma* and *Ijtihad;*

<u>Secondly</u>, Islamic Economics is a process i.e. it is not merely relevant quotations from the Quran and the Sunnah, but it refers to the

study of behaviour of producers and consumers (for example). This aspect of Islamic economics becomes particularly relevant, when we consider the case of economic development in Islamic perspective;

Thirdly, it presumes that economic values cannot be separated from either the social or the moral values, which is done in the case of modern economics; and

Lastly, it studies human behaviour with particular reference to production, distribution and consumption of goods and services[8].

4. ASSUMPTIONS

It is very important to know the basic assumptions on which the whole edifice of Islamic economics depends. Nay, an examination of the assumptions would in effect demonstrate the necessity and creditability of studying Islamic economics as a distinct branch of social science in this modern world. We now pass on to discuss some of the important assumptions of Islamic economics.[9]

(a) Belief in Islamic *Shariah*

The most fundamental assumption of Islamic economics is the men's belief in Islamic *Shariah,* particularly those that are relevant to the making of the subject. This means that the human economic behaviour, which is the main area of study of Islamic economics, is governed by the dictates of the Quran and the Sunnah. If any aspect of human economic behaviour is unavailable from these two sources, *Ijma* (that is, consensus based on agreed practice) and *Ijtihad* (i.e., fresh thinking) should be used, provided that the knowledge obtained from the latter two sources do not contradict in any way the former two.

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[8] For a survey of literature on the definitions of Islamic economics the readers are referred to M.N. Islam (1997).

[9] For a more detailed discussion on the assumptions, the readers are advised to see Mannan 1984, Chapter 2.

This assumption implies both rigidity and flexibility in the human behaviour. It is rigid in the sense that people (Muslims) can not, for instance, consume any commodity or commodities they like, although that or those commodities may be apparently permitted on health grounds (e.g. pork meat or wine) and flexible in the sense that if any one is forced by hunger, with no inclination to transgression, one is permitted to consume since Allah is oft-forgiving and merciful **[Maida 5:3]**. In this assumption, '---there is no claim that what is prohibited is all bad and what is enjoined is all good' (Zarqa 1989, p. 29). The Quran has also made no such claim. For instance, with respect to drinks and gambling Allah says, **'They question thee about strong drink and games of chance. Say: In both is great sin, and (some) utility for men; <u>but the sin of them is greater than their usefulness'</u> [Baqara 2:219]**. Al-Shatibi has exactly got this point when he says that every Islamic injunction may have both desirable and undesirable effects, and Islam bases its rules on the predominant effect. After all, man's knowledge is limited, and hence it is impossible for him to come to conclusions identical to Allah's injunctions and guidance!

(b) Belief in Allah's Sovereignty

This assumption owes directly to the Quran which says that all things between the skies and earth belong to Allah **[Baqara 2:284]**. That is, Allah, not any human being, is the **absolute** owner of anything. Man, however, as a vicegerent of Allah **[Baqara 2:30]** has been subjected to use everything in the skies and the earth **[Lukman 31:20]**. ' The only thing that man can truly claim to be 'his' is his 'will', which by the leave of God, is free' (Zarqa 1980, p. 11). All these imply that as an owner of any property, One has the legal right to use it for earning money, or can sell it to others, or even can give it to others free of cost; but, as absolute ownership does not belong to any one, one, as a vicegerent of Allah, has no right to destroy it, or more precisely, misuse it. For illustration, suppose Mr. X has 50 bighas of cultivable land. The present assumption would mean that if

these lands are suitable for producing 3 crops, he will have to strive to produce 3 crops, neither 1 nor 2; and, again, if the lands have access to irrigation facilities, he will have to strive to produce high-yielding-variety crops, and not local variety ones. Allah's sovereignty also implies that we must use the property in such a way that others are not harmed and also that we pay *Zakat* or *Ushr* out of the income according to the set principles of *Shariah.*

(c) Belief in 'Islamic Economic Man'[10]

Islamic economics deals with 'Islamic Economic Man' as distinguished from simply 'Economic Man'. For the purpose of the book, an **Islamic Economic Man** is defined as that man who has at least the following behavioural characteristics:

(i) The Islamic Economic Man as an economic agent will care for others and serve social objectives in all economic activities such as consumption and saving, investment and production, employment and work. The social objectives are: (1) fulfilment of basic needs of all human beings irrespective of age, sex, race, colour or religion; (2) balance and equity in the distribution of income and wealth; (3) stability; and (4) economic development.

(ii) He is motivated by self-interest and personal gain **within the framework of social objectives and care for others.** In other words, he is selfish as well as altruistic. Consequently, the Islamic economic order visualises a third sector, besides private and public sectors, known as voluntary sector.*

(iii) As a producer, he is not necessarily a profit maximiser: he may become profit maximiser but that would be subject to ethical and moral constraints of the *Shariah.* Most importantly, his decision

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[10] Mannan (1984, p. 24) has used the term **'Islamic man'** to (perhaps) describe the same characteristics as shown in the text. But since he has himself correlated this term with **'Muslim'**, his purpose of coining this new terminology may have been lost. I think the phrase 'Islamic Economic Man' is better and perhaps more appropriate here.

* For this new term 'voluntary sector', see Chapter 11, Section b(iii).

to save is closely linked to his decision to invest. This implies that in Islamic economics, the economic agents are not allowed to keep their surplus resources idle. They will have to utilise the fund for productive activities.

(iv) An Islamic Economic Man is always inclined towards co-operation and mutual consultation with a view to realising the social objectives. That is, **'Help ye one another in righteousness and pious duty'** [**Maida 5:2**]. This is particularly relevant to the relation between labour and management, consumer and producer, and government and business.

All these assumptions imply that people of any religion may behave like an 'Islamic Economic Man' provided that they follow the **socio-economic injunctions of Islam**. For example, any man may behave like an Islamic economic man if he does not eat his fill when his neighbour is hungry; or as a business man, when he does not hoard commodities for more than 40 days just to make more money at the cost of the general masses. After all, Islam is not merely a religion, it is also a way of life.[11]

(d) Belief in Dual Accountability

In Islamic economics, man is accountable not only to himself and his family, but also to his society (he belongs to) and Allah. This assumption is directly derived from the Quran and the Sunnah. For example, the Quran says, **'O ye who believe! Let not your riches or your children divert you from the remembrance of Allah' [Munafiqun 63:9]**. Again, the other way, **'But seek with the (wealth) which Allah has bestowed on you the home of the Hereafter, nor forget your portion in this world' [Qasas 28:77]**. There is an interesting *Hadith* in this connection. In one occasion, some Companions were giving descriptions of their religious doings. The Prophet noticed excesses in their doings and said, 'I have not been directed by Allah to live in this manner. Your body certainly has

[11] Characteristics of an Islamic Consumer (Chapter-3 Section 2 (a).

right over you; so fast but also abstain from fasting, and pray at night but also sleep. Look at me, I pray at night but I also sleep; I fast, but I also abstain from fasting. I eat meat as well as fat, and I also marry. So whoever turns away from my way is not with me' **(Bukhari, Muslim).**

This notion of dual accountability should be reflected in the behaviour of the people in the matters of, say, resource allocation, and resource use and resource maintenance. Mannan says, 'The main task of Muslim economists lies in striking a balance between temporal economic productivities and beyond temporal moral productivities. Thus the allocation of funds for construction of mosques, obligatory 'transfer payments', 'prayer break' during business hours, and a host of other matters have assumed economic significance in a special sense under Islamic economy' (Mannan 1984, p.39).

(e) Belief in Equal Human Dignity

Islam treats all human beings as children of Adam. [**Araf 7:31**]. One *Hadith* says 'all humans (al-Nas) are as equal as the teeth of a comb'. Islamic economics believes that all individuals are equal in their human dignity. Each individual's economic rights and responsibilities correspond with his capabilities. This implies that some differences would exist between adults, on the one hand, and the aged and the growing on the other, between male and female. Akram Khan rightly says, 'It promises a free, just and responsible world for everyone on this earth' (Akram Khan 1994, p. 2).

5. PRINCIPLES

The basic principles of Islamic economics are primarily derived from the Quran and the Sunnah and secondarily from the *Ijma* and *Qiyas*. For making the Islamic economics paradigm, these principles are of crucial significance. The overall economic principle in an Islamic perspective is stated thus:

> Everybody, irrespective of his age, race and regional status, must be given the opportunity to earn according to his/her ability and

capacity, and poor person who is unable to earn a living in spite of his/her best efforts, should be provided with his/her basic or essential needs, defined as such in a particular context.

Some of the fundamental principles are now discussed.

(a) Principle of Integration of Economic and Socio-moral Values

This is the most fundamental economic principle in Islamic perspective that categorically distinguishes it from the principle of modern economics. This principle owes its origin to the Quranic doctrine of *Tawhid* which implies that 'all life is one': man's commitment to none but Allah. 'Therefore, no separate sphere can claim independence of others, since it is the moral and spiritual version of man that harmonizes his economic, social, political and biological activities of society' (Mannan 1970, p.60). This necessity of integrating economic, social and moral aspects of human behaviour are actually recognised by the conventional economists too but, because of the **complexity** arising out of this integration, they strive to get rid of this by using such simplistic clause as *ceteris paribus* (other things being equal). For instance, demand depends upon income and prices, *ceteris paribus* (i.e., other variables such as tastes and preferences remain constant). In effect, material pursuits and spiritual persist are not independent in Islamic economics.

(b) Principle of Co-operation

In Islamic economics, mutual cooperation, rather than unrestricted competition, is regarded as an important principle. As the Quran says, **'But let there be amongst you traffic and trade by mutual good will'** [Nisa 4:29] or **'Help ye one another in righteousness and pious duty'** **[Maida 5:2]**. The economic implication of these Quranic dictates is, among others, that 'stress is to be given on the use of the technique of 'co-operative forces' in achieving equilibrium in different sectors of the economy' (Mannan 1984, p.36). Mutual consultation should be the way to arrive at a decision in socio-economic affairs, i.e. matters involving the interests of large number of the members of society, subject to the Islamic laws.

(c) Principle of Helping the Poor and the Destitute

This principle is also derived directly from the Quran which says, **'And in their wealth the beggar and the outcast had due share' [Zariyat 51:19]**. The implication of this principle is that in the Islamic economic system, there should be some institutional arrangements through which it should be possible to divert resources from those who have excesses to those who have little or nil. *Zakat* and *Sadaqa* can play an important role in this regard.

(d) Principle of Own Earning

The above principle (c) does not imply that in Islamic economics people are encouraged to beg or to remain idle. The reality is far from that. As the Quran categorically urges all men to disperse in the land and seek bounties of Allah after each morning prayer **[Jamua 62:10]**. One Hadith says, 'A man has not earned better income than that which is from his own effort' **(Ibn Majah)**.

In Islam, work is considered a virtue and idleness a vice. 'Charity is *Halal* neither for the rich nor for the able-bodied' **(Tirmidi)**. The Quran addresses the Prophet, telling him: **'... and say (to the Muslims): Work, soon Allah will see your work, and His messenger and the believers' [Towbah 9:105]**. It is said that in Islam the best worship is work. Manual labour is honoured in Islam. The Prophet is reported to have kissed the hand of a labourer. Further, monasticism and asceticism are condemned in Islam. The Prophet is reported as saying that 'those who provide food and other necessities to the one who spends all his time engaged in worship without attempting to earn a livelihood are better than him.'. It is, therefore, an obligation of an Islamic state to provide individuals with job opportunities.

(e) Principle of Earning Through Agriculture

In the Quran, while referring to His bounties and favours to man, Allah mentions the principle of earning through agriculture in the following words, **'And it is He Who sends down water from the**

sky. With it We then bring forth vegetation of all kinds; from some We produce green (crops) out of which We produce grain heaped up at the harvest....' [Anam 6:99]. And again, **'...And We have made means of sustenance in it for you and for those for whom you are not the providers....' [Hijr 15:20].** Thus there is a Quranic encouragement to engage in agricultural activity, for it has been made easy for him as divine favour. By engaging in agriculture, he gets an additional benefit as can be seen from the *Hadith:* 'When a Muslim plants a plant or cultivates a crop, no bird or human being eats from it without its being accounted as a (rewardable) charity for him' **(Bukhari** and **Muslim).** Agriculture, in Islam, is regarded as the primary source of livelihood.

(f) Principle of Earning Through Industries and Professions

From the Islamic point of view, it would be extremely undesirable if people limited their economic efforts solely to agriculture. The Prophet has warned the Muslims not to confine their activity only to agriculture and pastoral pursuits, otherwise they would be exposed to various dangers such as defeat, humiliation, and even loss of religious freedom. As one *Hadith* says, 'If you deal in usury, calling it by other names, and hang onto the tails of cows, being satisfied with cultivation and ceasing to perform *Jihad*, Allah will inflict a disgrace upon you which will not be removed until you return to your religion' **(Abu Daud).** According to Qaradawi:

> 'in addition to agriculture, the Muslim must develop such industries, crafts, and professions as are essential for the life of a community, for the strength of a free and powerful nation, and for the posterity and wealth of a country. As the great scholars and jurists have explained, the essential industries and professions are not merely permitted by the Islamic *Shariah*, but they are in fact an **obligation** on the Muslim community as a whole. Such obligations are termed 'the obligations of sufficiency' (*Fard Kifiyah*)' (Qaradawi 1960, p. 131).

The students should not get confused about the above two principles (e and g), since they appear to be contradictory in nature.

These are reconciled as: in a situation where food is scarce, agriculture should get top most priority; in a situation where manufactured goods are scarce, industry should get top most priority; and in a situation where goods are localised, trade should get top most priority. Therefore, whether emphasis should be put agriculture or industry would depend on the circumstances prevailing in the country concerned.

(g) Principle of Self-reliance

This principle actually strengthens the previous one (c). The Quran says that Allah will never change the condition of a people until they change it themselves. **[Rad 13:11]**. Its economic implication is that in the Islamic economic system, it is considered to be not worthwhile to make any effort to help a people unless and until they themselves come forward to put in hard labor in order to change their own socio-economic circumstances. In other words, Islam visualises a society where an individual is not dependent on others. It emphasises the need of each individual to actualise his potential abilities. Thus Islamic economics visualises a society where maximum number of people are independent in their earnings and living. In other words, Islamic economics placed a low value on wage-labour, and encourages self-employment.

(h) Principle of Just Distribution

'In order that it (wealth) may not (merely) make a circuit between the wealthy among you' [Hashr 59:7]. This urges that in the Islamic economic system there must be some provisions for the allocation or distribution of funds exclusively for the benefit of the poor and the needy as Grameen Bank has been doing in the country (although not in the Islamic way). This principle is expected to achieve the twin objectives of growth and equity in an Islamic society.

(i) Principle of Government's Role

In the present free market economy, the government's role would appear to be very much limited. In the Islamic economic

system, government is assumed to play a very active role. The activities would, among others, include: (i) perform those activities which are beyond the capabilities of individual enterprises (e.g. construction of roads, bridges, or maintenance of environmental balance), and (ii) guarantee the minimum education and health, shelter and food so that the poor can be productive and make their own minimum standard of living through their own efforts.

(j) Principle of Equality

Islamic economics believes in equality of men irrespective of their sex, region, colour, or race. In fact, the whole Quran is revealed in order to **'bring forth *mankind* from darkness to light' [Ibrahim 14:1].** Allah has created men from a single pair of a male and a female and made them into nations and tribes so that they may know each other **[Hujurat 49:13]**; and again, **'To men is allotted what they earn and to women what they earn' [Nisa 4:32].** Therefore, in Islamic economics, while making policy prescriptions, due importance are given to all types of persons, male or female, irrespective of their religion or race.

(k) Principle of R&D

The door of *Ijtihad* is not, as normally believed, closed in the Islamic world. Rather, it is one of the fundamental principles of Islamic economics. As the Quran says, **'And He has subjected to you, as from Him, all that is in the heavens and on earth; behold, in that are signs indeed for those who reflect' [Jathiya 45:13].** While elaborating this injunction, Abdullah Yusuf Ali in his *The Meaning of the Glorious Quran* says, 'Allah, in His infinite mercy, has given man the faculty to subdue the forces of nature and to penetrate through high mysterious with his powers of reason and insight'. This principle thus urges the Islamic economists to adopt R&D (Research and Development) as an important strategy for the socio-economic development of the society. Islamic scholars opine that if there is a shortage of qualified persons in some field of

essential science and industry, the entire Muslim community is blameworthy, especially those in positions of authority. As Imam al-Ghazzali says:

> 'Sciences whose knowledge is deemed *Fard Kifayah* comprise every area which is indispensable for the welfare of this world, such as ... medicine ... arithmatic ... agriculture ... weaving ... politics, and even cupping and tailoring. For if a town should lack a cupper, exinction would overtake its people and they would be driven to expose themselves to destruction ...' (as quoted by Qaradawi, pp. 131-2).

(l) Principle of Risk and Uncertainty

Last, but not necessarily the least in order of importance, is the principle of risk and uncertainty. The essence of this principle is that the future is unknown. As the Quran says, **'Lo! Allah! With Him is knowledge of the Hour. He sendeth down the rain, and knoweth that what is in the wombs. No soul knoweth what it will earn tomorrow, and no soul knoweth what land it will die. Lo! Allah is Knower, Aware' [Lukman 31:34]**. This principle prevents Muslim economists from making uncertain outcome certain. For instance, if somebody makes an investment, it is certain that his return would be uncertain. It is, therefore, natural that fixed and predetermined rate of interest should be treated as unIslamic.

6. NATURE AND SCOPE

Modern economics has been developed and has come to the present state through several stages, over perhaps, more than few hundred years. Islamic economics is also passing through stages. Truly speaking, it has started taking shape only after the Second World War. At this stage, Islamic economics literature is rather poor in elaborating the nature and scope of the subject. What follows are some tentative points regarding the nature and scope of the subject.

Islamic economics is a social science, but not like Sociology, Anthropology, Social Work, Political Science or History. Mannan

describes it as a 'composite social science' which implies that the study of Islamic economics is concerned with the social, economic and moral consequences of production, distribution and consumption in an integrated manner.

Although Islamic economics has developed basically from the perspectives of the Quran and the *Sunnah*, it cannot be regarded as a part of either of these, it is a discipline in its own right. Initially, Islamic economics was seen as merely quoting relevant verses from the Quran and the *Sunnah*. Truly speaking, this is not Islamic economics. It is in effect a *process* whereby the behaviour of the consumers toward the package of available consumer goods or the behaviour of firm as a producer unit is studied.

Islamic economics is neither fully positive, nor fully negative. Positive statements concern **what is, was or will be,** whilst normative statements concern **what ought to be**. Separation of positive from the normative statements is not at all important in Islamic economics. The Quran and the *Sunnah*, which basically serve as the basis of the Islamic economics, contain both the positive and normative injunctions.[12]

It considers total human welfare and fulfillment of co-operative and limited competition. Efficiency is an extremely important element in Islamic economic behaviour too. The Quran makes it explicitly clear that we must avoid waste i.e., **'.. and squander not (thy wealth) in wantonnes. Lo! the squanderers were ever brothers of the devil.' [Bani Israil 17:26-27].**

Like modern economics, Islamic economics also studies behaviour of economic variables but in a comprehensive and integrated manner. It includes imbibing with Islamic values of social responsibility in respect of obligatory sharing of wealth and income of the rich with the poor and the destitute.

In conventional economics, economic problem arises because of the 'niggardliness of nature'. It is assumed that man has unlimited

[12] See Zarka 1989, pp. 24-28.

wants to be fulfilled but the resources for their fulfilment is limited. So there is a supply constraint. In Islamic economics, it is maintained that Allah has provided sufficient means for the fulfilment of all human needs. Here, it is assumed that economic problem arises because of lack of efforts on the part of individuals and the society on the one hand, and unbridled human wants on the other. Islamic economics suggests that, in order to solve the economic problem, there should a two-pronged attack. On the one hand, there should be a cut of conspicuous consumption. Actually, an Islamic Economic Man does not try to fulfil all his wants but try to fulfil his 'needs'. Expenditures on such items as drinking, drug-taking, gambling, gluttony and production and stockpiling of weapons of mass destruction are considered purely wasteful. On the supply side, in Islamic economics, it is believed that if the Allah-given resources are fully and effectively utilised, there will be no problem of the human beings in fulfilling their needs.

The scope of Islamic economics is, by definition, wider than that of modern economics. There is a large class of economically relevant social and moral behaviour unit between the firm and the household. The study of consumption and investment loan without interest, supporting old parents, looking after the poor neighbours and people regardless of their race, colour and religion or orphans comes under the scope of Islamic economics. (Mannan 1984, p. 56)

Finally, question has been raised in the literature whether the scope of Islamic economics would be confined to Islamic society only. Its answer is simple and unambiguous. As Zarka says, 'I would definitely assert that the subject of Islamic economics is not restricted to Islamic society only but it also includes all economic behaviour whether it is according to Islam or contrary to Islam.' (1991, p. 56). This must be, as the injunctions of the Quran are not necessarily for the Muslims only. As said above, it calls to **'bring forth *mankind* from darkness to light' [Ibrahim 14:1].** Islamic economics will thus have universal application.

7. IMPORTANCE OF THE STUDY OF ISLAMIC ECONOMICS

Given the present state of conventional economics and its failure to deal with the socio-economic problems facing the modern world, particularly the third world countries, the study and the development of Islamic economics has become more important than ever before. The study is important not only for its own sake but also for the sake of bridging the missing link of the conventional modern economics itself. This would be clear from the following points.

(a) Bridging the Missing Link of the Conventional Economics

What is the link that the conventional modern economics has lost over time? The answer can be sought from the original makers of modern economics. One original and recognised maker is Aristotle (384-322) whose basic economic ideas, as can be seen from the history of economic thought, have been presented in the context of ethics. Even Adam Smith, who is generally known as the father of modern economics, was primarily a moral philosopher. His revolutionary book *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) was preceded by his *Theory of Moral Sentiments* (1759). 'Self-interest' was a much wider concept than we find today. His 'Prudence' represented wisdom, understanding and self-discipline. All three were regarded as essential parts of the whole exercise of self-interest.

However, no effort was made to clearly demonstrate whether the ethical values were desirable or not in accordance with the needs and aspirations of a people. Rather, economists like L. Robins went so far as to make such comments as 'ethics and economics are strange bed-fellows: there cannot be any link between the two'. Marshall tried to keep away the ethical and other values with the expression 'other things remaining the same' or 'other things being equal'. Gradually all efforts were diverted to something like engineering growth i.e., study in the mechanical relationship between different economic variables. Efficiency became the key concept around which the whole stream of conventional economics clustered with the result that the moral issue

went out completely by default. Having discussed the issue in historical perspective, Khurshid Ahmed arrives at the conclusion: During the pre-18th century phase, 'the economic problem, economic analysis and its relation with ethical values and norms were intertwined. They were merged into each other. It is in the post-18th century developments, despite its moral origins, that economics seems to have grown into a self-contained discipline' (K. Ahmed 1992, p.21).

From its very nature falsehood must perish, for it is the opposite of Truth and Truth must ever prevail **[as implied in Bani Israil [17:81]**. Even after the full switchover of the conventional economics from the socio-moral paradigm, the economists like Jacob Viner, Gunner Myrdal, John Galbraith, Paul Streeten, Lester Thurow, Heilbroner and others could not satisfy themselves with the falsehood but realised the truth and established that all that is being presented in the name of **positive economics** is not necessarily value-free. Amartya Sen, a Nobel Laureate, has rightly emphasised that 'moral acceptance of rights (especially rights that valued and supported and not just respected in the form of constraints) may call for systematic departures from self-interested behaviour'. He went on to add, 'Even a partial and limited move in that direction in actual conduct can shake the behavioural foundations of standard economic theory'. Paul Samuelson is also not unworried about this state of affairs and says, 'Economics is a growing subject in which very much is left to be done' (Samuelson 1971, p.351).

The study of Islamic economics is expected to establish linkage between economic values with socio-moral values. This integration between economic and socio-moral values imply, among other things, equitable distribution of income and resources **among all human beings and also among all living creatures.** The point to emphasize here is that the socio-moral dimension must be reflected in the economic development process. It is the study of Islamic economics that can make this happen. In other words, it provides a framework for such serious study, establishes linkage between the

principles of economics and Islamic *Shariah* and, thus, ultimately helps bridge the missing link of the conventional economics.

(b) Resolving the Crisis and Conflicts

Most third world countries, particularly the Muslim ones, are now facing crisis and conflicts in their development and modernization process. It is now widely believed that the current international order, which is in the state of crisis, seems incapable of explaining and influencing the course of contemporary events, and it is only Islam which can give solutions to these problems. Herein lies the importance of the study of socio-economic problems in an Islamic perspective, and hence Islamic economics.[13]

(c) Meeting Ideological Obligations

Muslims are under obligation to meet the ideological dictates of the Quran and the *Sunnah*. There are dictates, which may have universal appeal (e.g., to help the poor and the needy or to make optimum utilisation of available resources), and there are others, which may not have such appeal (e.g., not to eat pork meat or drink wine or to pay *Zakat* and *Ushr*). It is here that the Muslim economists should come forward, identify the relevant socio-economic injunctions in Islamic perspective and make use of them in making Islamic economics a scientific discipline. This explains the reason why the study and development of Islamic economics is so vitally important.

(d) Ensuring Effective Co-operation Among Muslim Countries

Mutual co-operation, and not unrestricted competition, has been identified as an important principle of Islamic economics. The Quranic verse **'O Mankind! Lo! We have created you male and female and have made you nations and tribes that ye may know each other' [Al-Huzurat 49:13]** implies that the boundary of co-operation goes beyond the national boundary. It means that in the

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[13] For a detailed discussion on this point, see Chapter 21.

matters of economic development, we should exploit each other's resources - both human and non-human - for the benefit of mankind. This needs the establishment and development of appropriate institutions. It is the study of Islamic economics which can make the types of institutions (such as Organisation of Islamic Conference or Islamic Development Bank) more effective and productive. The study of Islamic economics would be regarded as crucial for translating the various principles of Islamic economics through institution building into action.

8. DIFFERENCES BETWEEN ISLAMIC ECONOMICS AND CONVENTIONAL ECONOMICS

This section is devoted to note down the differences between IE (Islamic Economics) and CE (Conventional Economics) on the basis of five points namely, (a) pattern of property ownership, (b) pattern of production, (c) pattern of distribution, (d) pattern of consumption, and (e) pattern of exchange.[14]

(a) Pattern of Property Ownership

In CE both the public and private ownership of property are allowed. The underlying assumption in this case is that man's ownership of property is absolute implying that they have legal right to use, or even **misuse**, their property in any way they like.

In contrast, in IE, one can not consume any commodity of any amount disregarding the interests of the society, particularly of the poor and the needy. Allah is taken as the absolute owner of everything between the skies and the earth **[Baqara 2:284]**. Man can use the property only as a vicegerent of Allah. Since absolute ownership belongs to Him only, man can use the property for the benefit of himself, his family, his country, and for the whole mankind in general, but he has no authority to misuse it or use it as A tool of exploitation.

[14] See also Mannan 1984, Chapter 5.

Even he has no legal authority to destroy himself/herself. In a sense, it holds everyone accountable to Allah for the proper use of their resources.

(b) Pattern of Production

Producer's sovereignty is assumed in CE. They are guided by self-interest, and by the sense of keen compassion. They are allowed to produce any commodity, of any amount and at any place, as dictated by the price system, which is actually used as a means of ensuring efficiency. This reliance on freedom of choice is fundamental in CE. Maximization of profit is the ultimate aim of all the producers in this system.

IE puts emphasis on moderation between production efficiency and equity. Both economic and non-economic factors are taken into account in the decision-making process. IE does not deny the importance of self-interest for motivating men, but it does not accept the view that it is the only factor that motivates man in arriving at a decision. There is ample evidence in the conventional economics literature that self–interest is not necessarily the most important factor in arriving at a decision. While reviewing the factors of success of the Japanese economy in recent years, Khurshid Ahmed concludes that 'duty, loyalty, family traditions, cultural mores, good will and sense of belongings', rather than self-interest, 'have played important role in its industrial successes' (K. Ahmed 1992, p.24). Moreover, in IE, self-interest has been put into the context of moral values, norms and rules that are guided, not by men, but by the injunctions of the Quran and the *Sunnah.*

(c) Pattern of Distribution

Since CE gives emphasis on efficiency and growth, equity issue is neglected. The existing distribution of income and wealth is assumed to be given. The pattern of distribution in the capitalist system is always found to be skewed.

In contrast, if the Islamic principles of economics are implemented, the distribution pattern becomes just and equitable,

although dead-level equality of income is not expected. In effect, just distribution of income among different classes of people among different regions and races is the most important objective of Islamic economic system.

(d) Pattern of Consumption

Like producers, consumers' sovereignty is also assumed in the case of CE. Utility maximization is their goal and they have the freedom to consume any commodity of any amount disregarding the interests of the society. Consumption, according to Keynes, is a function of income.

In the case of IE, consumption is viewed both as a dependent variable and as an independent variable in the economic process. It is a function of not only income but also such other variables as compulsory transfer payments and Islamic ethics. Consumer's choice is guided by the subjective, ethical and spiritual norms.

(e) Pattern of Exchange

According to the views of the modern economists, exchange is impersonal and the money serves as a medium of exchange. Whilst in IE, it is social, impersonal and controlled all at a time in an integrated manner.

REFERENCES FOR FURTHER READING[15]

1. M. A. Mannan (1970); 2. M. A. Mannan (1984); 3. Khurshid Ahmad (1992). 4. M. Akram Khan (1994).

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[15] Details of these references are given at the end of the Book.

PART – II

MICROECONOMICS

'AND SPEND OUT SOMETHING (IN CHARITY) OUT OF THE SUBSTANCE WHICH WE HAVE BESTOWED ON YOU, BEFORE DEATH SHOULD COME TO ANY OF YOU AND HE SHOULD SAY, 'O MY LORD! WHY DIDST THOU NOT GIVE ME RESPITE FOR A LITTLE WHILE? I SHOULD THEN HAVE GIVEN (LARGELY) IN CHARITY AND I SHOULD HAVE BEEN ONE OF THE DOERS OF GOOD' [AL-MUNAFIQUN 63:10].

Chapter 3

THEORY OF ISLAMIC CONSUMER BEHAVIOUR

[**Key Concepts:** economic consumer – Islamic consumer – worldly consumption – consumption for the sake of Allah – importance of *niyyah* (intention) in Islam - want – utility – *Maslahah* – necessities or essentials – conveniences or comforts – refinements or luxuries- Islamic concepts of efficiency. riches, success – Last Day – concepts of reward and punishment – asceticism in Islam]

In Islamic economics, emphasis is given on the 'Islamic behaviour' of a consumer. For the sake of ease of exposition, a consumer whose behaviour is not against the norms the of Islam has been named as Islamic consumers'[1] In this chapter the contributions of three eminent Islamic economists along with the basic conceptual issues have been discussed. However, before we embark on the basic theme, a review of the conventional theory of consumer behaviour is attempted.

1. A BRIEF REVIEW OF THE CONVENTIONAL THEORY OF CONSUMER BEHAVIOUR

(a) The Essence of the Theory

The essence of the conventional theory of consumer behaviour can be stated as under.

The fundamental assumption of the conventional theory is that the consumer behaves 'rationally'. This rationality (which is often termed as 'economic rationality') implies:

(i) The consumers are able to rank commodities in order of preference. In other words, he can say, of the two goods (say, meat

[1] For a detailed discussion on this terminology, see Section 2.

and fish) which one is preferable to him, or, at best, when he equally prefers these two goods, he is indifferent;

(ii) Their preferences are consistent in the sense that they have the property of 'transitivity'. The term 'transitivity' means that if the consumer prefers meat to fish and fish to vegetables, he would prefer meat to vegetables;

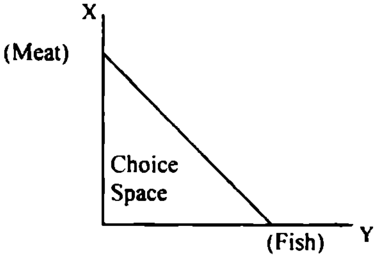

Figure 1: The Choice Space

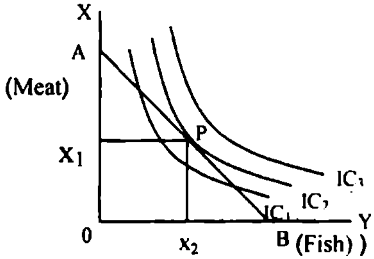

Figure 2: Maximisation of Utility

(iii) Positive prices of goods and income provide a certain choice space, as shown in Figure 1 given in the next page, from which he can make a choice; and

(iv) In order to make a choice in the choice space, it is assumed that the consumer's preferences are capable of being represented by **indifference curves** and that he chooses that combination of X_1 (meat) and X_2 (fish) which gives him 'maximum satisfaction or utility'. Technically, this also means that he maximises utility subject to his budget constraint. If the budget line is represented by the straight line AB (Figure 2), he chooses that combination of X_1 and X_2 within the boundary of his choice space at which the budget line touches the indifference curve. This happens at point P. At this point, the budget line touches the indifference curve 2(IC_2). He chooses OX_1 of meat and OX_2 of fish.

This is the essence of the conventional theory of consumer's behaviour. The elaboration found in the standard textbook of microeconomics simply relates to logical and mathematical extension of the above framework. It is not necessary to repeat it here.

(b) Some Observations from an Islamic Perspective

Some comments and observations on the conventional theory of consumer behaviour from an Islamic perspective can now be given. These comments actually serve as the basis for a new theory of consumer behaviour.

Firstly, the postulate of 'economic rationality' implies that the consumer's own desires are the best criterion for the formation of preferences. Naturally, defined in this way, rationality would mean different things to different people. For instance, if an individual consumer considers the consumption of alcohol to be quite rational, this may be considered by another individual (perhaps of the same society) to be completely irrational. Similarly, consumers of different societies may view rationality differently as a result of different beliefs and cultures. In other words, the concept of 'economic rationality' is not universal.

Secondly, the indifference curve analysis implies that the goods in question are perfect substitutes. From practical viewpoint, this may not be acceptable at all. There are many goods that can not be treated as substitutes, not to speak of perfectly substitutes. The commodities like pork and beef provide a glaring example in point. Moreover, a consumer may substitute one food item for another, or one clothing for another in response to price changes; but the same may not apply between two different needs, for example the need for food and the need for shelter, as a minimum of each is necessary for survival, The notion of Marginal Rate of Substitution (MRS) is not valid in this context. This shows that generalisation of the conventional theory is not possible.

Thirdly, in the conventional theory, the consumers are required to maximise utility subject to budget (income) constraint. This implies that more is always preferred to less. This otherwise is interpreted as saying that the consumers in the conventional theory is assumed to be **selfish**.

Fourthly, the demand function derived out of the utility analysis shows that it depends upon income and prices. Other

variables are lumped together, called 'tastes and preferences' and place them aside. In the conventional utility function, they are treated as exogenous variables, and thus can affect the consumer's behaviour but are neither affected by it nor by that of other consumers. It should be understood that 'tastes and preferences' include not only demographic and other personal characteristics of the consumer, but and most important for Islamic economics, also his beliefs and moral values. Under certain circumstances, these variables may become more important than the usual ones.

Finally, the conventional theory deals with the choice space, which involves the choice between present consumption and future consumption and that between substitutes. In the practical world, the choice between worldly needs and heavenly needs may arise but that is simply ignored. Besides, man is born in wants but all wants are not of equal significance. The utility analysis fails to take hierarchy of these wants or needs in consideration i.e. essentials, comforts and luxuries.

2. SOME BASIC CONCEPTS

In this section, for the benefit of the new readers, some important concepts relating to the theory of Islamic consumer behaviour are discussed.

(a) Islamic Consumer

(i) Who is an Islamic consumer?

The concept of 'Islamic consumer' is new in the world of conventional economics. It has already been stated that a consumer whose behaviour is not against the norms of Islam is called Islamic consumer. In this sense all Muslims come within this category. Since Islamic economics deals with Islamic consumer, it would be useful to know him in some details. The following are the important characteristics of an Islamic consumer.

- (1) A rational Islamic consumer tries his best to conform his consumption to the pattern so as to please Allah. In other words, his consumption behaviour is considered as a way to show his gratefulness to Him. This is also treated as an act of worship (*Ibadah)*, both satisfying in the present life and rewarding in the Hereafter.

(2) An Islamic consumer's total spending is classified into two categories namely, one, to achieve satisfaction in this world which includes both present consumption and future consumption, and two, spending for others with a view to earning reward in the Hereafter. This is derived from the Quran as: **'And render to the kindred their due rights, as (also) to those in want, and to the wayfarer....' [Bani Israil 17:26].** Again, **'... and forget not thy portion of the present life' [Qasas 28:77]**. The allocation between worldly spending and spending for the sake of Allah is left to the rational Islamic economic consumer. This in effect is the level of *Iman* maintained by the person concerned.

(3) He spends in moderation. In other words, he is neither miser nor extravagant in his consumption behaviour. Both asceticism and indulgence in excessive 'refinements' are prohibited. This also owes its origin to the Quranic injunction i.e., **'And let not thy hand be chained to thy neck nor open it with a complete opening, lest thou sit down rebuked, denuded.' [Israil 17:29].**

(4) An Islamic consumer does not hoard his wealth. He is required to 'save'. By necessity he must invest a major portion of his savings in productive activities otherwise *Zakat* would eat away his savings over time.

(5) Additionally, a **Muslim** consumer **quite consciously** consumes only the *Halal* things and avoids prohibited or *Haram* things. He does so in order to please Allah, the Omnipotent. *Halal* things refer to those things which contain moral and ideological qualities, whose consumption bring about benefits and welfare, and transferable and morally useful and there exists *Maslahah* in them.

(ii) Distinctions between an 'economic consumer' and an 'Islamic consumer'

From the characteristics of an Islamic consumer as described above, it is possible to show the differences between this type of consumer and an economic consumer. These are shown below:

Economic Consumer	Islamic Consumer
1. An economic consumer's behaviour is governed by the 'economic rationality' which in turn depends upon self-interest.	1. An Islamic consumer's behaviour is governed by the 'Islamic rationality' which in turn depends upon the degree to which he fears Allah.
2. Worldly consumption is the only source of his satisfaction.	2. Worldly consumption plus heavenly consumption (i.e. expenses for the poor) are sources of his satisfaction.
3. His satisfaction is derived from the present and future consumption.	3. In addition to these, his satisfaction is also derived from heavenly consumption i.e., consumption made basically for the poor and the needy.
4. An economic consumer does not consciously distinguish between *Halal* and *Haram* things.	4. A Muslim consumer very consciously makes this distinction and refrains from consuming *Haram* things.
5. If his income level permits, his consumption may go to any limit.	5. Even if his income level permits, he is not allowed to become extravagant.
6. He can voluntarily practice asceticism even below the poverty level.	6. He may be allowed to do so only when his consumption level has reached the 'sufficiency threshold' i.e., he has attained the *Nisab*.
7. Hoarding of his savings is not prohibited for an economic consumer.	7. This is prohibited for an Islamic consumer. He must invest a greater portion of his savings, otherwise, *Zakat* will eat it away over time.

(b) Distinction between 'Worldly Consumption' and 'Consumption for the Sake of Allah'

In Islamic economics, particularly for the theory of consumer behaviour, the distinction between 'worldly consumption' and 'consumption for the sake of Allah', or to use the Quranic words for

the latter, *'infaq-fi-sabil Allah'*, is very important. The term 'worldly consumption' is widely understood in the world of conventional economics. This simply refers to consumption or spending for present or future. The consumer is assumed to derive full satisfaction out of this type of spending.

What does 'spending for the sake of Allah' or *'infaq-fi-sabil Allah'* mean? To consider the Quranic terminology, the word *'infaq'* means spending, either for good or for bad. But, what is 'for the sake of Allah?' Allah Himself has provided an answer to this type of question in the Quran. That is: **'And they feed, for the love of Allah, the indigent, the orphan, and the captive, (saying) 'We feed you for the sake of Allah alone: no reward do we desire from you, nor thanks.'' [Dahr or Insan 76:8-9].** This implies that if somebody spends something for the 'poor' and the 'needy' without expecting any benefit, or even 'thanks', either directly or indirectly, from the beneficiaries, that would be regarded as 'spending for the cause of Allah'. *Zakat* and *Sadaqah* are good examples in point.

However, in the Islamic economics literature, the distinction between spending in the way of Allah and worldly spending is not very clear. For instance, according to Fahim Khan, 'It may prove to be very difficult to distinguish between spending for worldly needs and spending in the way of Allah. This is because one's acts can be of the first or the second type depending not on the nature of the act but the intention of the actor. Therefore, what we mean here, for the second type, is spending in the way of Allah other than on one's self' (1992, p. 172, foot note). To my understanding, this is a good operational distinction but it may give rise to two confusions namely:

Firstly, whether somebody is spending for worldly needs or for the cause of Allah is determined by the **'intention'** of the spender. This implies that if somebody spends for worldly needs, this can also be regarded as the spending for the cause of Allah provided, of course, that he has the right **intention**.

Secondly, 'spending in the way of Allah other than **one's self'** may lead one to believe that spending for one's own 'family' may have to

be regarded, **not** as spending for the worldly needs, but as for the cause of Allah!

The first confusion can be avoided if we relate the word 'intention' to 'reward'. An Islamic consumer spends his income either for worldly needs or for the cause of Allah in order to obtain reward in the Hereafter. This, in turn, is determined by his intention (i.e., *niyyah*) of the consumer. If he spends his income either for his worldly needs or for the cause of Allah with right intention, he gets reward in both the cases. However, if his intention is not right, he deserves punishment even if he apparently spends for the cause of Allah in the sense defined above. Therefore, the 'intention of the actor' does **not** make the distinction between spending for worldly needs and spending for the sake of Allah as propounded by Khan. It, rather, determines whether somebody gets reward or not. In other words the distinction between the spending for the worldly needs and heavenly needs is independent of the intention of the spender.

The second confusion can be avoided if, by the term 'one's self', we mean one's total consumption, that is, consumption not only for oneself but also for one's whole family.

Therefore, we can now define **'worldly consumption' as that part of total consumption which is made by the spender for himself and for his dependants, reward or punishment of which being dependent on his intention (*niyyah*). *Infaq-fi-sabil-Allah* or consumption for the cause of Allah,** on the other hand, can be defined **as that part of total consumption which is made by the spender for the poor and the needy without desiring any reward, or even thanks, from the recipients either directly or indirectly in this material world.** He would of course expect heavenly benefit or reward for the life Hereafter. Incidentally, the Quran has categorically mentioned the types of persons that should be included in the definition of 'the poor and the needy' as mentioned above.

To my understanding, these can be regarded as good working definitions for the analysis of the Islamic consumer behaviour.

(c) Want-Utility vs. Need-*Maslahah*

The conventional theory of consumer behaviour assumes that human beings have unlimited wants and that they always strive to satisfy all these wants. Want is regarded as the motivating force for consumer behaviour. It is assumed to be determined by utility. This 'utility' is described as the property of a good or service which satisfy a human want. Any economic activity to produce or acquire a thing is said to be motivated by the utility of that thing. Further, if something can satisfy any want, the human being will be willing to make efforts to produce or acquire or consume that thing.

Islamic economists criticise this 'want-utility' concept and opine that civilised human beings do not necessarily treat all these wants equally important. For them some are most important and some are less. Rice and carpet may be two wants of a person, but they can not be equally important. Even if the carpet is offered at a price much less than the price of rice, rice will still have priority. Because of this, in Islamic economics, the 'want-utility' concept is replaced by what is called the 'need-*Maslahah*' concept. Need takes the place of want and *Maslahah* that of utility. These are explained below.

It is assumed that all human beings have some 'needs' (instead of 'wants'). Some needs are most important (e.g. rice and wheat), some are less important (e.g. motor cycle and refrigerator) and some are least important (e.g. motor car and air conditioner). Naturally, the most important needs are to be satisfied first. Given the real world situations, this concept is not definitely 'normative' but very much 'positive' in character.

The distinction between 'want' and 'need' is not necessarily the invention of Islamic economists alone. One can find its existence even in the writings of Keynes. According to him, all needs of human beings 'fall into two classes - those needs which are **absolute** in the sense that we feel them whatever the situation of our fellow human beings may be, and those which are **relative** ones in the sense that their satisfaction lifts us above, makes us feel superior to our fellows. Needs of the second class, those which satisfy the desire for

superiority, may indeed be insatiable; for higher the general level, the higher still are they. But this is not so true of the absolute needs' (Keynes 1972, p.326). This classification implies that needs which are absolute, originate from within the individual himself and are necessitated by the human condition. In other words, their fulfilment is, therefore, necessary for human survival, comfort and development. In contrast, the relative needs include all status symbols and all goods and services which do not add to his well being. In Islamic economics, the 'absolute needs' are called simply 'needs' and 'relative needs' are called 'wants' (Chapra 1992, footnote, p.12). Thus we get a very important point, i.e., human wants (relative needs) may be unlimited but their needs (absolute needs) are limited.

As said above, want is determined by utility and in contrast need is determined by *Maslahah*. *Maslahah*, rather than utility, is the motivating force in Islam. *Maslahah*, an Arabic word, means welfare. Here the word 'welfare' refers to both 'worldly' welfare and 'heavenly' welfare. In conventional economics, if a commodity contains wordly welfare, the consumer feels tempted to consume it. In Islamic economics, a consumer feels the need of the commodity only when it contains both the wordly and heavenly welfare.

According to Shatibi, *Maslahah* is the property or power of a good or service that prompts the basic elements of the life of human beings. He has described five basic elements of existence in this world. These are (i) life, (ii) property, (iii) faith, (iv) intellect, and (v) prosperity. Of these, property and prosperity have direct relevance to economics. However, all such goods and services that have the power to promote these elements are said to be have *Maslahah*.

Fahim Khan (1992, pp. 175-76) has shown that as a concept of analysing the behaviour of economic agents, *Maslahah* is more appropriate than the traditional concept of utility. Some of these superiorities of *Maslahah* are highlighted below.

(i) Both utility and *Maslahah* are in a sense subjective. Whether a good or service has utility or *Maslahah* for a certain individual is judged by applying certain criterion. In conventional economics, the

criterion to determine utility is left to the subjective whims; whilst in the case of Islamic economics, this criterion to determine is not left to this whim of the individuals. In this case the criterion is fixed and universal. For example, whether tobacco has a utility or not, will be decided by different persons on the basis of different criteria. Some may say that it is fashionable and, therefore, it has utility. Some others may say that it stimulates body and hence it has utility. Still others may say that it is a substitute for immediate demand for food, hence it has utility. This is not however the case for *Maslahah*. The criterion is fixed for everybody and the decision will have be to made on the basis of this. This criterion is, of course, dictated by the Quran or the *Sunnah* or by other Islamic principles. For example, 'Every intoxicant is *Khamas* and every *Khamas* is *Haram'* (***Muslim***)

(ii) The individual utility may often be in conflict with social utility. For example, one may derive personal utility by drinking alcohol, but it may not have any utility whatsoever from society's viewpoint. In the case of *Maslahah*, there will be, in most cases, no such conflict, since the criterion for the individual or the society for arriving at a decision is the same.

(iii) The concept of *Maslahah* underlies all economic activities in a society. Thus it is the objective underlying production, exchange, as well as consumption. This is not so in the case of utility. For example, although maximisation of utility is the objective of consumption, maximisation of profit is treated as the objective of production.

(iv) It is not possible to compare the utility that person A gets from good (say, a mango) with the utility that person B gets from consuming the same good in the same quantity. In other words, how much satisfaction A or B enjoys by the consumption of a mango is not describable. Comparison of *Maslahah* in several instances, however, may be possible. It is at least possible to compare different levels of *Maslahah*. For example, one can compare the situation where person A may be protecting his life by eating a mango while person B, by the same act, may only be improving his health. In this case, *Maslahah* of A is certainly more than that of B.

(d) Categorisation of Social Utilities

Al-Ghazali, and later Al-Shatibi, by surveying Islamic teachings and injunctions in the Quran and the *Sunnah*, came to the conclusion that the social utilities in Islam can be categorised into three groups viz., **Necessities (*Daruriyat*), Conveniences (*Hajiyat*) and Refinements (*Tahsaniyat*).** These are described thus.[2]

(i) Necessities

According to Islam, necessities comprise all activities and things that are essential to the **preservation** of the five foundations of good individual and social life. These are **Religion, Life, Mind, Offspring and Wealth.** From the viewpoint of Islamic economics, some of relevant examples include: (1) establishment of *Zakat*; (2) meeting the five necessities of life, i.e., food, clothing, shelter, basic education and medicare; (3) prohibition of wine and other mind-attacking matters along with their production, distribution and consumption; and (4) protection of wealth, and prohibition of the destruction of wealth (even one's own), prohibition of transgression against the property of others, where needed by state intervention.

(ii) Conveniences

Conveniences comprise all activities and things that are not vital to the preservation of the **five foundations**, but, are needed to relieve or remove impediments and difficulties in life. These can of course promote and develop (rather than 'preserve') the 'five foundations'. These include those things that 'man can do without, but with difficulty'. Examples are air-conditioning in very hot countries, room heating in very cold countries, public transportation, sewerage in the busy towns, acquiring knowledge, promoting education, and so on.

(iii) Refinements

This category of social utility includes those activities and things that go beyond the limits of conveniences as described above.

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[2] The original ideas of these two Islamic Scholars have been slightly modified to suit the basic aim of the Book (to provide the necessary guidance to the 'Islamic Economic Man').

More specifically, it includes matters that do not remove or relieve difficulties but rather complement, or make the life more comfortable. Some examples are: (1) observance of Islamic etiquette in eating, drinking, clothing, cleanliness and activities associated with them; (2) improving the quality of one's work and production: 'Allah loves for one of you, if you do a job, to do it perfectly' ***(Al-Hadith)***; (3) activities relating to provide rest for body and mind, and to restore one's energies, recreation, innocent hobbies, etc); (4) things that provide comfort, such as carpet, good quality furniture, good quality wall painting, car, moderate amounts of objects of enjoyment and ornamentation such as flowers and jewellery, etc. i.e. things that one can forego without any difficulty whatsoever.

Concluding remark: The items belonging to each categorisation shown above may not hold true for all persons, for all countries and for all time to come. For example, a car may be regarded as refinement or luxury item for a common man, but it may be considered essential (necessity) for a doctor. In a hot country such as Saudi Arabia, air-conditioning may be regarded a necessity, it is sure to be considered as refinement in a country like Bangladesh. Again within the same country, in the rural areas, where the people are usually dispersed, sewerage is a convenience; but in a densely populated urban area this becomes necessity, because without it significant difficulties including health hazards are faced. Again, protection of health and promotion of physical education to strengthen the body is an example of convenience, but protection of life is a necessity.

3. TOWARDS A THEORY OF ISLAMIC CONSUMER BEHAVIOUR

Because of the shortcomings of the conventional theory of consumer behaviour, the Islamic economists are striving to develop a separate model for explaining the behaviour of Islamic consumers. Some attempts in this connection are discussed below.

(a) Contribution of Fahim Khan

Fahim Khan (1992) in his 'Theory of consumer Behaviour in Islamic Perspective' attempts to present the centour of the theory of Islamic consumer. This presentation is, in a sense, nothing but a comparative analysis of consumer behaviour under capitalistic and Islamic norms in terms of certain new conceptual issues. He has also dealt with the institutional framework required for their implementation. A brief analysis of contribution of Fahim Khan is given as under along with some comments.

(i) The Model

Fahim Khan begins his discussion with the practicability of 'positive' and 'normative' economics. Positive economies concerns what is, was or will be whereas normative economics concerns what ought to be. He applied the following criteria for comparison:

- Nature of the problem
- Concept of efficiency
- Scope of the theory
- Tools of analysis

He also discusses the institutional framework that will force the consumer to behave in the way outlined. The contribution of Fahim Khan is, therefore, presented under two subheads: Comparison between conventional theory and Islamic theory, and institutional framework required for their implementation.

(1) Comparison between conventional theory and Islamic theory

This comparison is attempted on the basis of the four points as noted above.

Nature of the problem: Man is borne in wants; but the resources that are required to meet the wants are limited. In the conventional economics, the consumers are assumed to maximise satisfaction subject to his limited resource or income. Islamic economists' query: Are human wants fully satisfied? In effect, 'wants'

themselves begets wants. Galbraith (1969) is right when he asks: How can production be defended as want-satisfying if that production itself creates wants? Thus their satisfaction remains vague. The capitalistic ideology leads the individuals to pursue this objective irrespective of how vague or unattainable it is.

In Islamic economics, the economic problem of an individual is defined in an entirely different dimension. It is the religious duty of an Islamic consumer to earn for his betterment not only in this world but also in the world Hereafter. Shatibi has used the word *Maslahah* (welfare). The activities that have *Maslahah* for human beings are called 'needs'. An Islamic consumer's objective is to 'fulfil needs' rather than 'satisfy wants' as in the conventional theory.

Concept of efficiency: As resources are limited, an economic consumer tries to 'economise' their use. This is known as 'efficiency' i.e., 'doing the best with what we have'. He tries to achieve the greatest possible satisfaction out of the scarce resources. Efficiency is thus the prime concern in the conventional economics.

In contrast, the prime concern of an Islamic consumer is not necessarily the efficiency. 'Desirability' becomes as important as efficiency, the desirability being determined by *Maslahah*. The issue can be explained as follows.

In Islamic economics, the needs are broadly divided into three categories namely, **essentials** *(daruriyat)*, **complementarities** *(hajiyat)* and **amelioratories** *(tahsaniyat)*. Essentials (i.e., necessities, such as food, shelter, clothing, education and medicine) are to be met first. In Islamic economics, it is assumed that as necessities are limited, resources can not be limited to meet them. 'This is against the promise of Allah and against realities' (Fahim Khan 1992, p. 177). Economising on necessities does not arise at all. Once the necessities are fulfilled, complementarities and amelioratories are to be fulfilled. Here resources may be limited. Therefore, the question of efficient use can not be ignored. But Islam demands, in addition to efficiency, that the Islamic consumer must see whether his demand, beyond necessities, are **desirable.** In effect, as resources are available, efficiency and desirability are simultaneously used for fulfilling the

complementarities and amelioratories. In other words, in the case of an Islamic consumer, efficiency and desirability together become the prime concern. 'Where, there is conflict, desirability will get preference over efficiency.' (Ibid. p. 177).

Scope of the theory: The scope of the theory of the Islamic consumer behaviour is much wider than that of the conventional theory. This is evident from the following points.

The conventional theory of consumer behaviour concentrates on two choices i.e.,

- the choice between present consumption and future consumption, and
- the choice between substitutes in each case.

In contrast, the theory of consumer behaviour in Islamic framework, has four choices, including the above two. The other two choices that are ignored by the conventional theory, are:

- the choice between worldly needs and heavenly needs, and
- the choice among the different types of needs (i.e., essentials, complementarities and amelioratories).

Tools of analysis: Maximisation of satisfaction is the basic objective of the conventional economic analysis. Hence, the mathematical tools of convex curves, differentiation, etc. can be applied. Since in Islamic economics maximisation of satisfaction is not accepted under all circumstances, the conventional tools of analysis are not applicable without qualification. For instance, in Islamic economics, the consumer faces the choice between 'spending for worldly needs' and 'spending in the cause of Allah'. The choice between these two types of needs can not be compared with the choice between two goods as is done in the conventional theory. In the conventional theory, the consumer can spend his entire income on any one of the two goods in order to maximise his satisfaction. But in the case just referred to here, the consumer is **not** allowed to spend his entire income on 'for the cause of Allah': **'... and forget not thy portion of the present life' [Qasas 28:77]**. Hence, the indifference curve analysis is not applicable in this case.

In Islamic economics, balancing principle is applied. As the Quran says, '**Those who, when they spend, are not extravagant and not niggardly, but hold a just (balance) between those (extremes)' [Furqan 25:67].**

In Islamic economics, a large part of preference ordering is in the nature of lexicographic ordering rather than convex ordering. This implies that separate tools of analysis would be required for the analysis of Islamic consumer behaviour.

(2) Institutional framework

As stated above, Fahim Khan in his attempt to build up a theory of Islamic consumer behaviour has also given an outline of the type of institutional framework that is needed to force the consumers in an Islamic economy to behave in the manner outlined above.

The capitalist system provides 'market' as an institution for the consumers to pursue their objective. There are also special institutions to meet some specific needs of such individuals who are unable to use the conventional institutions to satisfy their wants. According to Fahim Khan, all these institutions (normal and special) are required to guide the consumer behaviour in an Islamic economy too. However, there are some especial characteristics of an Islamic consumer which can not be handled properly either by the market institutions or by the special institutions as mentioned above. These peculiarities can be stated as under:

- By human nature, consumers will be inclined to pursue their own *Maslahah* and hence inclined to indulge in prodigality *(Israf)*. For example, the consumers may like to eat to their full while their neighbours are starving, or they may like to reap the advantage of very high prices by hoarding goods for more than forty days and, hence, causing harms to others, particularly the poor and the needy.
- A rich consumer may continue fulfilling complementarities and amelioratories neglecting his attention to even faith, reason *(Din)* or posterity *(Nasl)*.
- The consumers may not pay any attention to the fulfilment of such social needs as education, health, research and defence.

• The consumers may get involved in conspicuous consumption on the pretext that this is pursuing amelioratories or refinements (*Tahsaniyat*).

All these require that the consumers be motivated by some mechanisms or other to:

• abstain from prodigality,

• be consistent in the fulfilment of needs at the three levels (i.e., essential necessities, complementarities or conveniences and amelioratories or refinements), and

• abstain form gross deviations from Islamic economic principles.

Surely these requirements can not be met by the institutions operated through capitalist norms. What we need is special type of institutions that are non-market in character. Measures are to be taken to implement these institutions. Some discussions on this issue follow.

Voluntary institutions: Voluntary institutions will have to be developed through adequate education and training of masses in *Shariah*. *Shariah* basically provides complete freedom and autonomy to the individual to take his own decision and be responsible to Allah on the Day of Judgement (*Akhirah*). For Islamic economic behaviour, adequate education and training in *Shariah* is very important. This will not only induce the individual to exercise self-restraint (not to deviate from the Islamic principles) but will also help develop voluntary social institutions to monitor (or control when necessary) individual behaviour. Besides this *Shariah* promotes social institutions to fulfil social obligations (e.g. *Fard Kifayah*).

Enforcement institutions: These will mainly be state institutions and can prevent the individuals to refrain from activities that create social or economic disorders in the society. These should intervene in the following activities of the consumers in an Islamic society.

• Consumption of prohibited goods which amounts to violating the law and order in the society;

• Conspicuous consumption activities which are responsible for such things as unrest, feeling of jealousy and depravity in the society;

• Prodigality or excessive propensity to consume luxury goods when the basic needs of the society remains unfulfilled; and

• Gross deviant or inconsistent behaviour from the point of view of Islamic principles such as spending the bulk of the budget on luxury goods ignoring the essentials.

(ii) Some Comments

Fahim Khan has made a number of contributions towards building a theory of consumer behaviour in an Islamic perspective. While presenting and comparing the contours of the Islamic theory of consumer behaviour vis-à-vis the conventional theory, he has not only identified the inadequacies of the latter but has shown the superiority of the former on the latter. His suggestion for creating especial non-market institutions for forcing the Islamic consumers to behave in the way required by the *Shariah* is laudable. However, some observations can be made on his analysis in the following way.

Firstly, the theory of consumer behaviour presented by Fahim Khan can be regarded as an outline only: it is not a complete one.

Secondly, he has quite correctly pointed out that the tools of the conventional theory are not adequate to handle the Islamic theory. But he has not dealt with the alternative tools that will be applicable for explaining the behaviour of Islamic consumers. He, of course, mentions that the 'maximisation' principle of the conventional theory is likely to be replaced by what is called the 'balancing' principle. But how do we implement it? How one makes balance between worldly consumption and heavenly consumption or between present consumption and future consumption? How to incorporate the balancing principle into our mathematical analysis? These issues appear to have been left for future research.

Thirdly, his distinction between 'worldly spending' and 'spending for the cause of Allah' is well taken. But the

conceptualisation of these terms is rather confusing. He says. '.... one's acts can be of the first (i.e., worldly spending) or the second (spending in the cause of Allah) type depending not on the nature of the act but the **intention** of the actor.' This implies that, depending on one's intention, 'worldly spending' may also be regarded as 'spending in the cause of Allah' provided, of course, he has the right intention. This is not perhaps plausible. What appears to be more plausible is that whether a consumer will be **rewarded** either for spending for worldly needs or for spending in the way of Allah, **depends on his intention.** He is, however, right when he says that when some one spends something 'other than one's self' that can be regarded as spending in the cause of Allah, provided that by 'one's self' we mean **'one's family'** and not for **'himself'** only as implied in the statement.

(b) Contribution of Anas Zarqa

(i)The Model

In his 'A Partial Relationship in a Muslim's Utility Function' (1992), Anas Zarqa has given a new dimension to the theory of consumer behaviour. According to him, one fundamental difference between the conventional theory and the Islamic theory is that the utility function of the latter has a new variable in it, namely, the reward or punishment in the Hereafter. This new variable (in addition to this quantities of different commodities consumed) so strongly interacts with others variables (both economic and non-economic) in the utility function that it merits a separate study. Zarqa's model deals with a partial relationship between this reward/penalty variable and another economic variable that affects utility i.e. total consumption of the individual. Note that this consumption (C) is just one of type of many actions that affect reward (R). One possible hypothesis may be that the relationship between R and C is negative as depicted in Figure 3. This shows that the more one gives in terms of consumption, the higher is the reward.

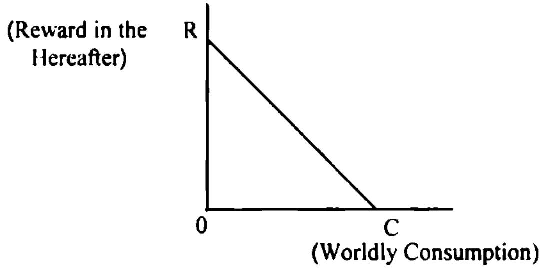

Figure 3: Relationship between Worldly Consumption and Reward in the Hereafter.

Although very simple, this type of relationship does not actually depict the Islamic consumer's expected behaviour. From an Islamic viewpoint, one is not allowed to spend one's entire income in the way of Allah. He must spend a certain minimum income for his worldly consumption, **'Seek amidst that which Allah has given thee, the last abode, and forget not thy portion of the present life' [Qasas 28:77].**

Zarqa's model of Islamic consumer behaviour is presented in terms of a diagram as shown in Figure 4 below. In the figure the vertical and horizontal axes are shown, respectively, reward (R), punishment (-R) and worldly consumption (C). The segments shown are ordinal only, indicating 'more or less' relationships. Before we go on to show the relationship R and C, let us explain the concepts as noted in the figure.

Levels of Consumption: Zarqa distinguishes four **levels of consumption** shown in the horizontal axis of the figure. These are explained thus.

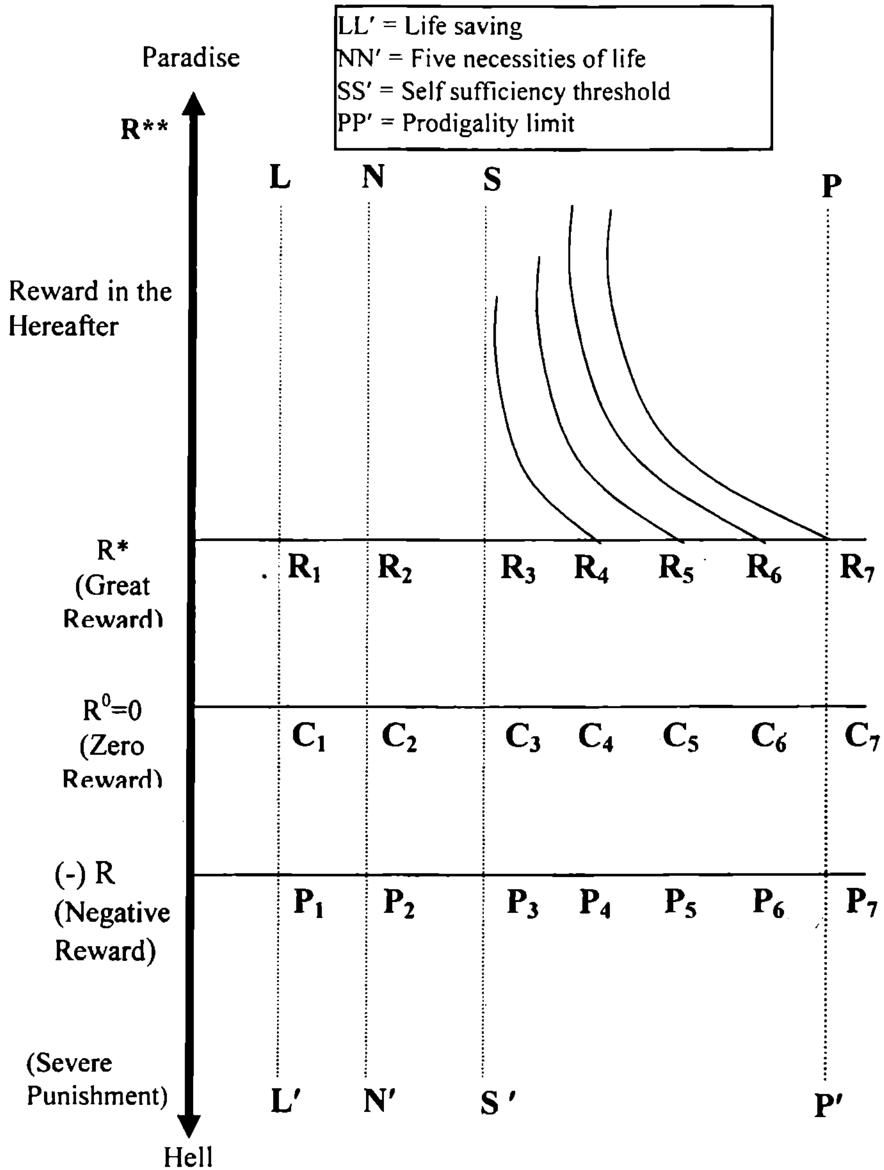

Figure 4: Zarqa's Model Showing the Partial Relationship in a Muslim's Utility Function

(i) **Life saving:** this means that human being requires a minimum level of consumption in order to sustain life. This is represented by the dotted line LL′. According to the diagram, no one can survive if his/her consumption level is less than OC_1. This level of consumption is called 'life saving'.

(ii) **Necessities:** This is the amount required to preserve the five 'necessities' other than life. The five necessities are food, clothing, shelter, education and medicare. In the conventional economics this is called 'basic needs'. This is denoted by the dotted line NN′ and the amount required is OC_2 [i.e., $OC_1 + (C_1+C_2)$].

(iii) **Sufficiency threshold:** This is the level of consumption at which an Islamic consumer will always try to reach. This level of consumption covers important 'conveniences' that are sufficient to make a person financially self-sufficient so that he can not only support his family including his parents (if they are alive) but also can help others. The dotted SS′ line depicts this limit and the corresponding quantity of consumption is denoted by OC_3.

(iv) **Prodigality frontier:** This, in a sense, demarcates a consumption level that corresponds to the maximum permissible 'refinements'. Consumption beyond this limit would imply that the person in question is indulging in extravagance which is not allowed in Islam. **'... But waste not by excess: for Allah loveth not the wasters' [Anam 6:141].** Or this may also mean that he is not spending his excess income in the way of Allah or even not investing it for earning *Halal* income. The dotted line PP′ represents this limit. The amount of consumption permitted in Islam is OC_7.

It should be noted that consumption levels represented by the vertical lines LL′, NN′ and SS′ are not identical for individuals but depand, *inter alia,* on one's family obligations, health, psychology and self-control. But for a given consumer, these levels are well defined.

Levels of Reward

In the similar fashion, Zarqa distinguishes five **levels of reward**. These are shown in the vertical axis as described below:

(i) **Zero reward:** This situation arises when a consumer consumes legitimate *(Halal)* things and avoids consuming forbidden *(Haram)* things, but he does so unconsciously. He is regarded as 'absent-minded' consumer and neither rewarded, nor punished. In the figure, referred to above, this zero reward is shown at point 0 (R^0) on the vertical axis. This corresponds to line segment C_1 C_7. However, if his consumption level exceeds C_7 (prodigality limit), he will be committing a specific and punishable violation.

(ii) **Great reward:** In terms of consumption in an Islamic perspective, this situation holds good when the person concerned consumes only those things which are permitted by Allah and avoid those which are forbidden. He does so in order to please Allah, the Omnipotent. This also demands that the consumer shares his consumption with others to the extent that is required by Islam i.e., paying *Zakat, Sadaqah,* etc. *Zakat* becomes operational only when the consumer attains a level of income that allows him to consume beyond the sufficiency threshold limit. This is shown by the notation R* on the vertical axis of the diagram. By dint of one's actions, one can reach up to paradise, the greatest reward a Muslim can think of. This corresponds to line segment R_1 R_7.

(iii) **Negative reward or punishment:** This is shown by '-R' on the vertical axis. If one, by dint of his consumption behaviour, goes further down, one is sure fall in the Hell, a place for severe punishment. This situation arises when the consumer consciously consumes forbidden things like wine, pork, etc., neglects the needy or helpless members of the society in general and his relatives in particular, and refuse to share his consumption with others even when his consumption level exceeds prodigality limit. This corresponds to line segment P_1 P_7.

(iv) **Parsimony and harmful asceticism:** This represents a special case. An Islamic consumer is expected to reach the consumption level at least up to the threshold level (C_3). If it happens that the person concerned is a good Muslim and has the capability to consume up to the threshold level but he is not doing so because he is lazy or stingy, he is considered as ascetic. This type of asceticism is

not allowed in Islam, and he is penalised for that. His position will fall below the 'zero reward' on the vertical scale.

It should be born in mind that a consumer who is not able to reach the threshold level despite his best efforts is regarded as involuntarily poor. For consumption level lower than the stated amount, he is not penalised. But his intention and behaviour will place him at C_1C_3, R_1R_3 or at the most unfortunate segment, P_1P_3.

(v) **Altruism and voluntary asceticism:** In this case it is assumed that the person concerned has achieved the capacity to consume up to prodigality limit, C_7. He is a good Muslim and decides to consume less than his capacity, but above the threshold level. He may be helping others financially, spending in the way of Allah, or devoting further energies to worthy social causes. This is called 'Islamic asceticism'. It should be remembered that in Islam one is not rewarded when one refrains from the consumption of permissible consumption. It is rewarded only when it becomes a means to a worthy end. Abstinence from the *Halal* for its own sake is entirely alien to Islam. This is an important difference from some other religions that encourage self-denial and asceticism *par se.*

Therefore, whether an individual is placed at zero reward, great reward or punishment (minus R) is a function of two factors i.e.:

* his belief and 'intentions' *(niyyah)* as regards consumption, and
* his consumption behaviour.

Against this background, the Islamic utility function can now be explained in terms of the relationship between R and C. According to Zarqa, R is just partially related to C, because there are factors which do affect the level of R, besides C. Segment-wise relationships are now discussed.

(i) **$0 - C_1$:** As shown above, this is the level of consumption that is necessary for saving one's life. Under such circumstances, the Muslims are allowed to consume anything including those that are prohibited under normal circumstances. This is permitted by Allah. As the Quran says, '....... **He hath explained to you in detail what is**

forbidden to you - except under compulsion: of necessity?...' [Anam 6:119]. Consequently, it is safely presumed that R is independent of C in this segment of the consumption scale (O-C_1).

(ii) $C_1 - C_2$: By assumption all consumers will maintain this minimum level of consumption. In the Islamic state, if any individual or family, is unable to fulfil this basic needs, it becomes the duty of the state to help him procure this minimum level. He is not supposed to forgo any portion of consumption for the cause of Allah under this situation. Therefore, the relationship between R and C would be expected to be positive in this level of consumption. Even with this level of consumption the person in question may reach up to paradise or down to hell depending upon the two factors just mentioned above.

(iii) $C_2 - C_3$: As in (ii), in this segment too, R is inferred to be positively related to C. The argument for this type of relationship is similar to above. Every consumer is expected to maintain at least this level of consumption. This in a sense makes the family self-sufficient. Although he is not expected to make any sacrifice, his intention and consumption behaviour will place him either above 'zero reward' (towards paradise) or below 'zero reward' (punishment).

(iv) $C_3 - C_7$: This is the segment that lies between the sufficiency threshold (C_3) and prodigality limit (C_7). Zarqa's contention is that a rational Islamic consumer would always strive to reach this level of consumption. It is to be remembered that Allah's instruction is not to receive *Zakat* but to pay or collect it. Herein lies the conflict between belief in the Hereafter and his natural desire for the good things of the present life. Hence an inverse relationship is expected. Zarqa has some curves which he called 'indifference curve' as in the traditional economics. These curves are shown in the diagram refereed to here. The curve is drawn convex to the origin almost like an indifference curve of the conventional theory. This implies 'one *poisa* may be rewarded more than thousand *poisas*' i.e., a small sacrifice from the relatively poor persons may earn a greater reward than a large sacrifice from a relatively rich person. Another interesting feature of this curve is that it does not cross the SS' line

but approaches it asymptotically. This implies that Islam does not usually approve voluntary sacrifices from one who is below the sufficiency threshold. In other words, voluntary asceticism before the SS′ consumption level is not approved by Islam.

Conclusions

However, Zarqa arrives at the following conclusions (without further elaboration): Consumption and reward are two important variables in the Islamic utility function. The rational Islamic consumer will:

(1) not settle before the attainment of the sufficiency threshold (if he can afford it) because he will be penalised if does so: this is treated as harmful asceticism.

(2) not settle beyond the prodigality frontier because he will be penalised as well as for indulging in excessive refinements disapproved by Islam; and

(3) always strive to settle somewhere between the 'sufficiency threshold' and 'prodigality frontier' (except for the very poor who can not reach SS′).

(ii) Some comments

Zarqa's contributions towards the theory of Islamic utility function, as distinguished from the conventional utility function, is highly appreciated. His ingenuity lies in the fact that his analysis incorporates virtually all the principles of Islam in consumption and their relation with the Islamic *Aqida*. The diagrammatic representation is also unique in the domain of Islamic consumer behaviour.

However, Zarqa's analysis can not be regarded as a complete one. He has himself, of course, termed it as a partial analysis. An important deficiency is that his theory has not actually dealt with the behaviour of the 'rational' Islamic consumer which represents consumer preferences among consumption opportunities available for him. How to settle and at what point are also left open for further clarification. He has also left out any discussion on savings and the behaviour of a rational Islamic consumer in relation to it.

In spite of these comments, his analysis will go a long way in developing an appropriate model for explaining the behaviour of an Islamic consumer.

(c) Contribution of Monzer Kahf

(i) The model

There are two points that need consideration while developing the theory of Islamic consumer behaviour. These are: (1) the consumer values, and (2) the tools of analysis. Monzer Kalf (1992) appears to believe that Islamic economists should give more emphasis on the former than the latter. In other words, the tools of analysis as used by the neo-classical economists may be used in analysing the behaviour of an Islamic consumer.

According to him three general principles dominate the economic behaviour of human beings in the Islamic culture i.e., belief in:

- the Last Day,
- the Islamic concept of success, and
- the Islamic concept of riches.

These concepts are briefly described below.

The Last Day: An Islamic consumer believes in the **Day of Judgement** and his life is extended beyond death. This belief in the dual life has two implications in so far as the consumer behaviour is concerned. First, the outcome of a choice is composed of two parts - its immediate effect in this life and its later effect in the life to come. Therefore, the utility derived from such a choice is the total of present value of these two effects. Second, the number of alternative uses of one's income is increased by the inclusion of the benefits to be gained in the Hereafter. Examples of such alternative uses include free of charge lending (*Qard Hasan)*, helping the poor and the needy and care for animals.

Islamic success: This is defined in Islam in terms of the 'consent of Allah' and not in terms of 'accumulation of wealth' as commonly believed. The Islamic consumer would, therefore, behave in such a fashion that pleases Allah. This requires people to spend part of their time and energy for the remembrance of Allah. This can only

be done if part of human resources can be spared and liberated from the pursuit of consumption.

Islamic riches: The concept of wealth and income *(mal)* is unique in Islamic Economics *Mal* is a bounty from Allah and can be used for good or evil. Since riches are a bounty from Him, they must be used for the benefit and satisfaction of human wants. The relationship between income or *mal* and consumption is defined by the Prophet in the following saying: 'You do not really posses your *mal* but that you eat and use up, that you dress and wear up, and that you spend on charity and preserve (for the life in the) Hereafter' (***Muslim***). Thus *mal* is a tool to buy goods and devices which bring about satisfaction and hence it should be spent for that purpose and not be hoarded.

All these three principles imply that the Islamic consumer maximises the 'consent of Allah' or *fallah* or in more economic terminology, 'success' subject to the bounty of Allah i.e., income and wealth *(mal)*. In other words, the Islamic consumer maximises satisfaction derived from the consumption of goods and services in this world and in the Hereafter subject to an income constraint determined by the level of 'spendable income'. 'Spendable income' is defined as total income minus planned change in wealth, the latter is also termed as 'savings'. It is to be remembered that, according to Kahf, savings is not defined as the difference between income and consumption as in the conventional theory but is conceived of as a positive act that has its own purposes. People save for a variety of reasons such as precaution for the future, accumulation of wealth for the benefit of the heirs and raising one's economic status.

More formally, using neo-classical tools, Kahf presents his model of consumer behaviour in the following way:

$$\text{Max } U = U(FS, S)$$

$$\text{Subject to: } FS + S = Y$$

Where,

U = consumer satisfaction (or utility)

FS= final spending which comprises spending for the present life and spending for the cause of Allah: this does not yield any income

S = savings as defined above
Y = spendable income as defined above.

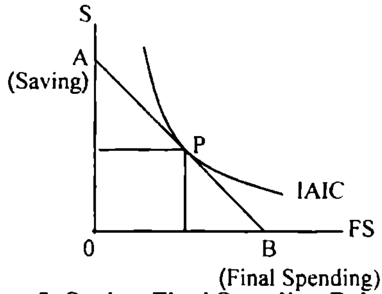

Figure 5: Saving-Final Spending Relationship.

The students of traditional economics would note two important differences in the above model when compared with the conventional theory of consumer behaviour. First, here the choice is between FS and S, and not between commodities (say, x_1 and x_2) as in the traditional theory. Second, in the traditional theory the consumers are assumed to spend his entire income; in contrast here the consumers are required to spend and also to save. In effect, the inclusion of 'savings' in the utility function is an innovation in the Kahf-model.

The basic question posed: How does the consumer allocate his income between FS and S in order to maximise his satisfaction? For this the traditional indifference curve technique is utilised. As shown in Figure 5, S and FS are represented on OX and OY axes, respectively. The straight line AB depicts income level. Its slope reflects the trade-off between the current purchasing power and the future purchasing power of one unit of income. Prices are assumed constant. The curve IAIC is actually the 'income allocation indifference curve' which is assumed to have all the important characteristics of the traditional indifference curve. That is, it has a negative slope, it is convex to the origin, and no two curves cut each other. On the saving-final spending scale, one can locate all the points of combination of savings and final spending that produce the same level of satisfaction to the consumer. Maximum satisfaction is

attained (that is, equilibrium is established) at the point where the AB curve (that is, the budget line) touches the highest income allocation indifference curve. In Figure 5, this point is P. At P, the marginal rate of substitution of S for FS equals the slope of the budget line where, IAIC stands for income allocation indifference curve.

(ii) Some comments

The consumer behaviour theory as propounded by Kahf has been criticised.[3] Some of the comments are as follows:

First, since each income allocation indifference curve implies a given level of income in money terms, it may not be possible to draw an indifference map between FS and S as drawn in the case of conventional indifference curve (where one has two commodities, in place of FS and S). Here a higher income allocation indifference curve shows increased amounts of S and FS and would be possible only at a higher income level.

Secondly, the equilibrium point as shown at point P, may not mean much in this case as the slope of the IAIC and that of the budget line, which has an implicit level of money income, may turn out to be the same.

Thirdly, the income allocation indifference curve may not show diminishing marginal rate of substitution between S and FS through its entire region. The curve must become parallel to the OX axis in the beginning showing a minimum level of FS necessary for human life. Similarly, it must become parallel to OY axis if there is to be a minimum saving level. This would certainly reduce the trade-off between S and FS.

In spite of these rather adverse comments, Kahf is probably the first Islamic economist who has brought savings in to the consumer behaviour analysis. This has opened the scope for more work in the area of Islamic consumption function.

REFERENCES FOR FURTHER READING[4]

1. Fahim Khan (1992), 2. Monzer Kahf (1992), 3. Anas Zarqa (1992b)

[3] See Ausaf Ahmad (1992, p. 255).

[4] For details, see the list of references given at the end of the Book.

Chapter 4

ISLAMIC THEORY OF DEMAND AND SUPPLY[1]

[**Key Concepts:** Effective need – effective supply – basic need – critical Islamic concern line – consumers' surplus – producers' surplus – potential consumer gap zone – potential producer gap zone – Islamic demand curve – Islamic supply curve – elasticities of Islamic demand and Islamic supply – transfer payments – non-price rationing – socialisation of pricing policy – guided co-operative price]

The conventional theory of demand and supply is well known to the students of elementary economics. From an Islamic perspective, there may appear to be nothing wrong in so far as the tools of the analysis of this theory are concerned. However, the Islamic theory would be different in terms of conceptual issues involved in the analysis. This chapter is devoted to:

- review the conventional theory of demand and supply
- introduce the essence of the Islamic theory of demand and supply, and
- identify the basic issues and search for Islamic alternatives to market mechanism.

1. A BRIEF REVIEW OF THE CONVENTIONAL THEORY OF DEMAND AND SUPPLY

This section is divided into two sub-sections i.e., (a) the basic elements of the theory, and (b) comments on the theory in an Islamic perspective. We begin with the first.

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[1] The basic materials of this chapter are drawn from Mannan (1984).

(a) The Basic Elements of the Theory

The basic elements of the conventional theory of demand and supply are discussed here.

(i) Basic concepts

In conventional economics, the word 'demand' is defined as a want of goods and services backed by willingness and ability to pay. It depends upon (other things remaining constant) price. The relationship between demand and price is negative for all normal goods and services. The word 'supply', on the other hand, is defined as the amount of goods and services brought to the market by the suppliers or producers, *ceteris paribus*. It also depends on price. Unlike demand, its relation with price is positive. Market mechanism operates through these forces of demand and supply in the capitalist economy. (see Figure 1 below).

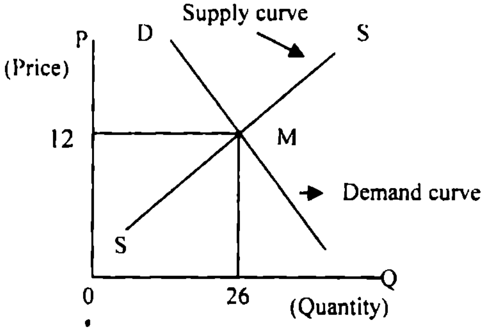

Figure 1: Determination of Price and Quantity under Conventional Economy.

(ii) Determination of price

By rule, the consumers always try to buy a commodity at lower price, and the suppliers, on the other hand, always try to sell a commodity at higher price. If the price is high, consumers buy a smaller amount than when the price is low. The producers do just the opposite. Ultimately, equilibrium is established at a point where the amount willingly supplied and the amount willingly demanded

become equal. Mathematically, this mechanism can be illustrated as follows:

$$D = 50 - 2P$$
$$S = -10 + 3P$$
$$D = S$$

Where, D = demand, S = supply and P = price. Since D = S, we write

$$50 - 2P = -10 + 3P$$
$$\text{or,}\quad P = 12 \quad \text{and} \quad D = S = 26$$

Thus when the price is Tk 12 per unit, the quantities demanded and supplied become equal i.e., 26.

This result can also be demonstrated in terms of a diagram i.e.,

In Figure 1, the downward sloping demand curve has intersected the upward sloping supply curve at point M. The same result is obtained. That is, equilibrium price is TK 12 and quantity demanded and supplied is 26.

(b) Some Comments from an Islamic Perspective

(i) Islamic perspective

What is the Islamic concern that is relevant here? This is the interest of the poor and the under-privileged people of the society. Islam's stand on the poor is clear and categorical. For example, we quote one verse from the Quran and one from the **Bukhari** ***Hadith*:**

> **'And in their wealth the possessions (was remembered) the right of the (needy), him who asked, and him who (for some reason) was prevented (from asking)' [Zariyat 51:19].**
>
> 'The man who exerts himself on behalf of the widow and the poor, one is like the one who struggles in the way of Allah, or the one who keeps awake in the night (for prayer) and fasts during the day' **(Bukhari).**

Therefore, any mechanism that does not incorporate the interest of the poor and the needy would be considered as unacceptable in the eye of Islam. The implication of this perspective is that when all prices are allowed to be determined by the 'invisible' forces of demand and supply the Islamic concerns as noted above may

not be accomplished. In effect, the market mechanism is either indifferent or incapable of handling adequately this Islamic concern.

(ii) Some comments

Against the background of Islamic perspective, some comments on the conventional theory of demand and supply are given below.

Firstly, since the market mechanism operates through the forces of demand and supply, the working poor who lives below the poverty line can not enter into the market. That is, they can not buy the goods and services at the going price (Tk 12 per unit in Fig. 2, for instance), their income levels are too low. They remain outside the market.

Secondly, for the similar reason, the non-working poor i.e., the unemployed, who are incapable of earning an income sufficient to buy the goods at the going price also remain outside the market.

Thirdly, price determined through the forces of demand and supply also ignores the interest of the small and under-privileged producers who can not enter into the market, because the goods they produce are above the selling price due mainly to the fact that they lack easy access to the input market, to say the least.

Fourthly, the market, i.e. the demand-supply theory, may be indifferent to the choice of the certain features of the social welfare function. In practice, something may have to be imposed if the society is not aware of its severe consequences. The best known example is the consumption of tobacco having adverse effects on health.

Fifthly, there are many needs the price of which can not be determined by the forces of demand and supply. Non-material needs such as participation and maintaining identity are an example in point.

Lastly, there are some needs such as safe water, sewerage, etc., which can be met at a cost much beyond the means of the poor. These types of needs are required to be fulfilled beyond the forces of demand and supply.

Thus, it can be concluded that by establishing equilibrium price, the market may ensure distributional efficiency but can not do

anything with respect to equity. It may be added that in an Islamic economy, the people are essentially free to enter and to leave the market, subject to the condition that they can not enter into any economic transaction which may come in conflict with the principles of Islamic economics.

2. INTRODUCING THE ISLAMIC THEORY OF DEMAND AND SUPPLY

(a) Conceptualisation

As noted above, in the conventional theory, 'demand' is defined as a want for goods and services backed by **willingness to buy** and **ability to pay**. We have also noted that the poor who live below the poverty line have a want, willingness to buy but have no **ability to pay**. Similarly, in the case of supply side, the small and under-privileged producers can not enter into the market due mainly to the fact that the market prices are too low in relation to their costs of production or the costs of production are too high in relation to the prevailing market prices. One possible reason is that they do not have **access to the means of production**. These imply that the poor consumers and under-privileged producers, who constitute about three-fourths of the total agents of the third world countries, including the Muslim ones, are left out of the market. If their interests are to be considered, perhaps nobody would deny that, the whole theory needs to be re-conceptualised.

In the Islamic theory, the term 'demand', is replaced by 'need' which implies a want for goods and services backed by willingness to buy, but the ability to pay **may or may not be there**. 'Demand' and 'need' become equal when both are backed by willingness and purchasing power. Mannan, proposes to use the term **'effective need'**, in place of simple 'need' and considers it as an instrumental concept. This, according to him, 'suggests that if a particular goods and services is a necessary condition for the accomplishment of a desired end-state or goal, then that service is **needed'** (Mannan 1984, p. 202).

The source of end-state is of course rooted in the Islamic concept of social justice and equity, which demands that if a service is needed, in the sense defined here, it becomes the responsibility of the society or state to meet that need irrespective of the cost involved.

For simplicity, we would prefer to use the term **'Islamic Demand'** rather than 'effective need'. By Islamic Demand (ID) we mean two types of demands namely, normal demand which is determined by market price and 'potential demand' which is determined by forces outside the market. That is:

ID = ND + PD

Where,

ND = normal demand, as determined by the forces of demand and supply, and

PD = potential demand of people who have the need but do not have the necessary purchasing power.

In Figure 2, the quantity determined by the forces of demand and supply is shown to be OL, which represents Normal Demand, and the extra demand beyond this represents Potential Demand.

where,

DD_1 = market demand curve

SS_1 = market supply curve

OP = equilibrium price (= CL) obtained at the intersection of the DD_1-SS_1 curves

OL = equilibrium quantity at which demand equals supply.

Similarly, the term 'supply' is replaced by **'Islamic supply'**, which includes the supply of Normal Producers as well as the supply of the under-privileged producers.[2] This may be shown as:

IS = NS + PS

Where,

IS = Islamic supply

NS = normal supply as determined by the intersection of the demand and supply, and

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[2] Mannan has used the terminology 'potential-capacity-based-supply' for Islamic supply and for Islamic demand 'effective-need-based-demand'.

PS = potential supply of the small and under-privileged producers.

In the figure, OL is normal supply and beyond this potential supply.

(b) Critical Islamic Concern Line

Critical Islamic Concern Line (CICL) is a vertical line drawn at the intersection of the conventional Demand-Supply curves. This line testifies the amount that is produced and consumed most efficiently i.e., OL. This line is critical from the Islamic perspective simply because of Islamic concern, i.e., the concern for the poor consumers and under-privileged producers begins here. The basic ingredients of the CICL can be illustrated with the help of a diagram (due to Mannan 1984, p.200) as follows.

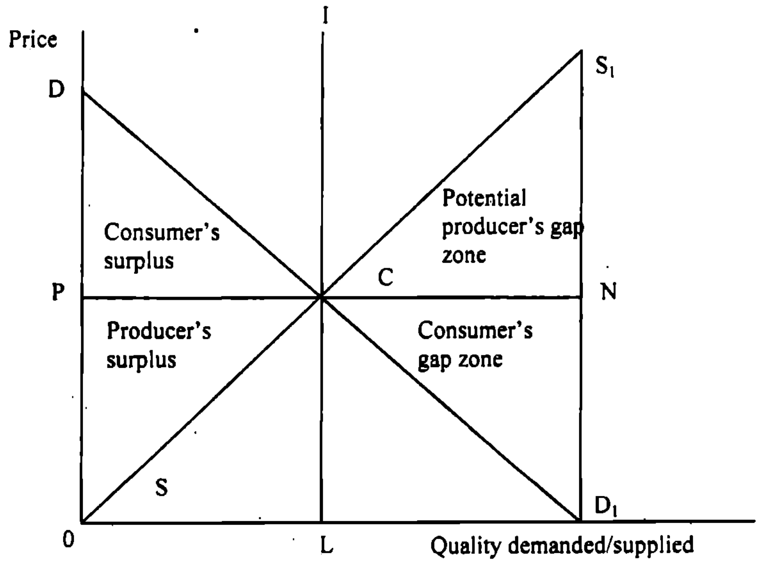

Figure 2: Market Price, Consumer's Surplus & Producer's Surplus and Potential Consumer's & Producer's Gap Zones.

Figure 2, in addition to this equilibrium situation, provides information on consumer's and producer's surpluses. These concepts are vital for the understanding of the concern line we are driving at. **Consumer's surplus** is defined as the difference between the prices one is willing to pay and the actual paying. In this figure, his total revenue, at the equilibrium price, is OP (price) x OL (quantity) = rectangle OLCP. But quantity gives him total utility (expressed in terms of money) is the area OLCD. This happens because the consumer was actually **willing to pay** a price higher than OP (even close to OP′). However, the difference between these two areas (OLCD - OLCP) is the consumer's surplus. This is shown by the area P′PC.

Producer's surplus is defined as the difference between the price at which one is willing to sell his goods and the price at which one is actually selling. In the diagram, his total selling price is OP (price) x OL (quantity) = OLCP. Since he was willing to sell at a lower price previously, he has some surplus. This surplus, called 'producer's surplus', is the area OCP. This is the difference between the OLCP (i.e., the amount the seller has actually received) and the area OLC (i.e., the amount he was **willing to receive**).

The figure also demonstrates another important information. At the equilibrium price, there remains an unknown number of consumers who were expecting still lower prices. For them the going price is too high and, therefore, they could not buy any commodity. In other words, they remain outside the market. The unsatisfied demand is shown by the area CD_1N. This area is technically called **'the potential consumer gap zone'.** The figure also shows that at the going price, an unknown number of producers could not sell their goods because they were expecting still higher price. For them the going price is too low. In other words, they remain outside the market. The potential amount is shown by the area CNS_1. This is technically known as **'the potential producers gap zone'.** The market mechanism thus does not allow the poor consumers as well as the under-privileged producers to enter in to the market.

Therefore, we can now draw a line through the intersection point C as ICL. This is the line called **'Critical Islamic Concern Line'.** On the left of the line both the consumers and the producers are assumed to be **efficient** because they have used their money most efficiently. On the right of the line an unknown quantity of goods and services could not come to the market. That is, an unknown number of buyers and sellers could not enter the market. In effect, Islamic concern begins here. Islamic economists strive to find out ways and means so as to bring those unsatisfied consumers and producers in to the activity market.

(c) Islamic Demand and Supply Curves

Against the background, it is now possible to show the nature of the Islamic demand and supply curves as distinguished from the conventional demand and supply curves. The following diagrams borrowed from Mannan 1984 (Chapter 9) demonstrate the Islamic demand and supply curves.

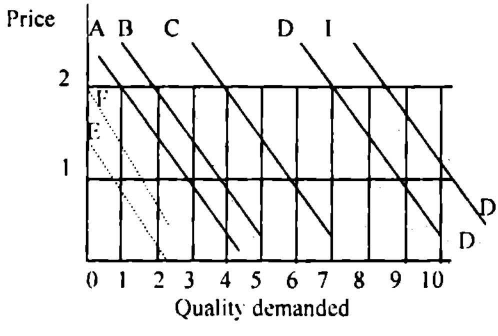

Figure 3: Individual and Market Demand Curves: Conventional and Islamic.

(i) Islamic demand curve

In Figure 3, both the conventional and the Islamic demand curves are shown. As usual, vertical axis and the horizontal axis measure, respectively, price and quantity demanded. It is assumed that

there are altogether 5 consumers in the market. They are named as A, B, C, E and F. It is also seen that at the market price, Tk 2 per unit, A, B and C buys, respectively, 1, 2 and 4 units. E and F can not afford to buy at the going price. They have the **willingness** to buy but have no **ability to pay.** Hence they remain outside the market. Hence, the consumers with ability to pay can all (3 in number) together buy 1+2+4=7 units. Adding these three individual demand curves, we can draw the conventional market demand curve as DD.

In Figure 3, A, B, C, E and F are individual demand curves. DD represents the market demand curve of the conventional economics. In other words, it is the summation of A, B, and C individual demand curves (E and F are outside the market mechanism). ID is the Islamic demand curve. In addition to the 3 individual demand curves the Islamic demand curves also include those who are outside the conventional market (here, E and F). This is the reason why the ID curve lies away from the DD curve.

In Islamic economics, an attempt is made to bring the poor consumers either through the transfer payments or through other means into the market. It is to be noted that the slope of the Islamic demand curve may or may not be the same as the conventional market demand curve.

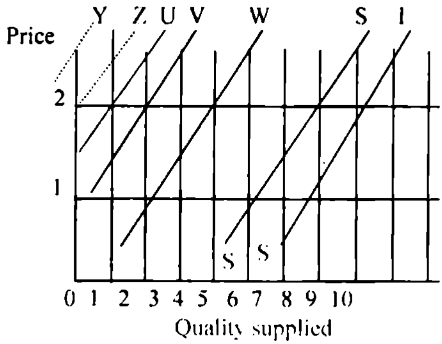

Figure 4: Individual and Market Supply Curves: Conventional and Islamic.

(ii) Islamic supply curve

In the similar fashion, it is possible to draw the Islamic supply curve. Figure 4 carries the necessary ingredients. Here also it is assumed that there are altogether 5 sellers in the market i.e., U, V, W, Y and Z. It is shown that the sellers U, V and W can sell their commodities at the going price of Tk 2 per unit. The quantities they can sell are, respectively, 1, 2 and 4 units. That is, all together, they sell 7 units. The individual supply curves are added up to get the market supply curve i.e., SS. This is the conventional market supply curve. It is seen that the seller Y and Z do not afford to sell their goods at the going price. In other words, Y and Z are potentially capable, but can not enter in to the market due to institutional constraints such as access to credit and working capital. Therefore, these sellers or producers remain outside the market.

In Islamic economics, it is the responsibility of the concerned authorities to strive to provide all possible help and co-operation to these small and under-privileged producers. In effect, potential supply in an Islamic framework is based on the full utilisation of potentialities of both the privileged and the under-privileged producers. It is, therefore, likely that in an Islamic economy, the number of sellers would be larger i.e., the size of the market would be wider. This implies that the Islamic supply curve would lie to the right of the conventional market supply curve. This is shown by the curve, IS (Islamic supply curve). The slope of the IS curve may or may not be equal to that of the conventional market supply curve (SS).

The crucial policy implication of the above analysis is that the Islamic demand curve and the Islamic supply curve deserve greater attention by all policy makers irrespective of the type of economic system they identify themselves.

(iii) The role of equilibrium price

Here we wish to say a few words about the role of equilibrium price. In the market economy, there is a **unique** equilibrium, which is established at the point of intersection of the demand and supply curves. This gives an equilibrium price.

Before we go on to present the Islamic standpoint in this regard an interesting *Hadith* may be quoted:

> Somebody requested the Prophet to fix the price. In reply the prophet said, 'Allah fixes price. He increases and decreases prices and gives subsistence. I want to return to Allah in such a state that no right of anybody is due on me' **(Abu Daud & Tirmidi).**

What does 'Allah fixes the price' mean? This only means that the forces of the demand and supply fix the price. Commenting on this *Hadith*, Ibn Taimiya said, 'Those who interpret this *Hadith* of the Prophet concerning the fixation of price, that fixation of price is forbidden in all circumstances, they are mistaken for it was an order to meet a special circumstance, not a general order. In this *Hadith*, it has not been said that some one refused to sell some goods which was bound to sell or he refused to do something which he should have done (which was *Wajib* for him) or he demanded excess price over the normal price.' Again, Shah Waliullah commenting on the same *Hadith* said, 'I want to say that to establish such justice that nobody is loser or both are equally loser, is difficult. For this reason, the Prophet became careful so that rulers do not turn the principle of fixation of price by general rule. But even after this if there is open and clear oppression by the business community then it is permissible to fix prices, for the destruction of the country lies in oppression.'[3]

This implies that the intersection of the Islamic demand and supply curves may give an equilibrium **but that will not be unique.** Here prices, determined by the forces of demand and supply, is **not taken as granted**. The basic problem considered is the existing level of inequality of income. Market price can serve as a guide to social welfare only after the establishment of the equitable distribution of income in the society. In Islam, prices tend to be **personal and humane** in character whereas in the market economy it tends to be **impersonal** in nature. Maximisation of profit or satisfaction is the main goal there.

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[3] As quoted (both) by Hannan 1991, pp. 12-13.

(d) Elasticities of Islamic Demand and Islamic Supply

Elasticities of demand and supply are an important concept in economic analysis. They measure the degree to which the quantity demanded or supplied respond to changes in price. When income is considered in place of price. the concept is known as income elasticity. The vital question for the Islamic economics: Is price elasticity of demand (or supply) at all important? Which factor is more important, price or income? Mannan very strongly asserts that it is the income, and not the price, which is to be considered as the most important determining factor for influencing either Islamic demand (i.e., effective need, as it is called) or Islamic supply (i.e., effective supply, as it is called). The reaction of 'needs' to changes in income is concerned with not only to mitigate the sufferings of the poor but is also interested in evolving a consumption pattern for the rich in an Islamic society.

(i) Islamic demand-based income elasticity

Like the conventional income elasticity of demand, Islamic-demand-based income elasticity can be defined as:

$$Ey = \frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in income}}$$

Or, symbolically,

$$Ey = \frac{dQn}{dY} \times \frac{Y}{Qn}$$

Where,

Ey = elasticity of Islamic demand-based income elasticity
Qn = quantity demanded
Y = income
dQn/dY = derivation of Qn with respect to income

(ii) Islamic supply-based income elasticity

The same question arises in connection with the supply elasticity too. Is the price elasticity or elasticity of access or ownership to the means of production or wealth more important for an

Islamic producer? According to Mannan. 'The reaction of producers to produce to changes in the pattern and organisation of the distribution of all credit, investment resources and public and private services is far more important than price elasticities of supply in an Islamic economy .... It is far more important to measure credit elasticity of supply, equity elasticity of supply, supply elasticities of social and physical infrastructure ....' (pp. 228-29)). These elasticities can be measured by using the conventional tools. For example:

$$Sc = \frac{\text{Percentage change in Islamic supply}}{\text{Percentage change in credit}}$$

Or, symbolically,

$$Sc = \frac{dEs}{dC} \times \frac{C}{Ps}$$

where,

Sc = elasticity of Islamic supply with respect to credit

Es = effective supply

C = credit

dEs/dC = derivation of Es with respect to C.

Once these elasticities are estimated, they can serve as useful guide to resource reallocation and redistribution. One major use of these elasticities in an Islamic economy is to influence the redistribution of resources in such a way as to enhance the under-privileged producers to enter in the activity market. The task here is not only to de-emphasise the role of price elasticities of demand and supply but also to direct the use of resources for the benefit of the poor.

3. THE BASIC ISSUE AND THE ISLAMIC ALTERNATIVES

The basic issue has already been identified. This lies in converting the socially indifferent consumer's and producer's surpluses in to a humane and socially concerned use and exchange. In this section, objectives. functions and policy options of Islamic alternatives will be discussed.

(a) Objectives

The following objectives are intended to achieve:

(i) To ensure transfer of purchasing power from the rich to the poor and needy so as to attain the goal of equitable distribution of income and wealth in the society; and

(ii) To maintain a level of prices, particularly of the essential goods and services, which are within the reach of the poor members of the society.

(b) Functions

The pricing policy in an Islamic economy must perform the following three functions:

(i) **Economic functions:** It must perform an economic function in so far as it relates to increased productivity and increased income of the poor;

(ii) **Social function:** It must perform a social function and maintain a social balance between the haves and have-nots: it should be noted that dead level equality is neither desirable nor acceptable in the eye of Islam; and

(iii) **Moral function:** It must perform a moral function in furthering the 'Cause of Allah'.

(c) Policy options

An Islamic economy may face three policy options namely: (i) elimination of the market mechanism, (ii) market mechanism and transfer payments, and (iii) controlled market mechanism. These options are discussed below.

(i) Elimination of the market mechanism

One option for the Islamic economy may be to eliminate the market mechanism completely and bring the pricing system under full control. This option is not acceptable in Islam, however. The reason is very simple. Islam believes in economic freedom of individuals. Note that it goes directly against the *Hadith* quoted from ***Abu Daud & Tirmidi***.

(ii) Market mechanism and transfer payments: The second option is to allow the market mechanism to operate freely and make direct transfer payments to the poor and needy so that they can enter into the activity market. This is the option that is being followed by many developing countries including many Muslim ones. According to Mannan (1984, Chapter 9), this is not an ideal option that an Islamic country should follow. Several arguments are put forward in support of this assertion. Firstly, this option assumes that the market mechanism will automatically ensure equitable distribution of income through the invisible forces of demand and supply. Experiences of the modern countries suggest that the reality is far from this. Secondly, there is no guarantee that the transfer payment will be made available to the poor on a permanent basis. This may relate to certain socio-political situations prevailing in the country. The best example is pre-election time when the existing government makes this type of provision for the poor in order to obtain votes: After the election, the government simply forgets mainly because of its inability to continue this venture. Mannan points out further that even if the transfer payment is made purely for increasing the productivity of the poor, it may not even guarantee an increase in their income. For example, in the case of small and under-privileged farmers their productivity increase may be reflected in lower prices, thus, benefiting the urban consumers. Thirdly, as it has already been noted above the market mechanism is either indifferent or ineffective in providing all aspects of the basic need of the general masses in the society.

Since the above policy options are either against the very principle of Islam or are not considered ideal for reaching the goal of equitable distribution of income and wealth in the society, the only alternative available to an Islamic state is the third alternative i.e., the controlled market mechanism. This policy option will now be discussed.

(iii) Controlled market mechanism

Under this option, market mechanism is allowed to operate freely but subject to necessary control and corrective measures whenever and wherever needed. The purpose is to ensure basic needs for the poor. The pricing options, as suggested by Mannan, are briefly stated thus.

• **Non-price rationing** is one of the pricing decisions that can be considered in an Islamic economy. This means allocation of essential goods and services through a system of coupons. When combined with limited operation of the market mechanism, it may very well take care of both the equity and the efficiency criteria. The hypothesis is that while rationing will ensure that the poor people get their basic allotment, the market would allocate some surplus part of the commodity supply to those rich people with the greater ability to pay. Under this scheme the poor would not have to sell their allotment. If they need their basic allotment, they will keep it. Otherwise they could supplement their income by selling it. It is important to point out that under this scheme, 'demand' and 'need' become inseparable.

• **Zero prices through 'N' pricing for public utilities and services** are another alternative. Under this scheme, some basic quantity of public utilities or services (e.g., water, electricity, gas, etc.) may be provided free of charge to the very poor and the needy. The additional consumption in excess of the prescribed minimum quantity is, of course, to be paid.

The consumption of such public utilities or services at various prices suggests that pricing policy is to be based on the measurement of the consumer's surplus. This implies that the loss incurred by the discriminating monopolists in providing free services up to a certain basic limit to the poorest of the poor members of the society can be recovered by an appropriate pricing policy from the rich people who certainly be willing to pay extra to their discriminating monopolists, rather than forgo these 'essential' goods and services.

• **Socialisation of the pricing policy** is also an important Islamic alternative. By this we mean determination of a sectoral or national 'mark-up policy' made by the competent authorities. A guideline for a range of mark-up may be expressed in terms of **average cost.** Given the best guess, this may be dictated by the state of authorities concerned. If there are indications that there are economies of large-scale production, the average cost figure needs to be adjusted downwards to fix the range of mark-up, and vice-versa.

• **Guided co-operative prices** may also be considered to be another alternative policy option. This implies nothing but fair prices for both the consumers' goods and producers' inputs. This requires state intervention. The state may encourage the small consumers and producers to form co-operatives among themselves. The objective behind the consumers' co-operatives is to ensure a fair price by reducing the fluctuations of essential goods and that of producers' co-operatives is to reduce agricultural fluctuations and to raise their income levels. 'The Islamic distinctiveness of this plan lies not on the emphasis of co-operation among producers and consumers themselves but on the co-operation between producers and consumers. They need to be retold that producers and consumers should not be seen as two opposing interest groups where the clash of interests are worked out by opposing forces of supply and demand and where buyers contend against buyers, sellers against sellers as well as buyers against sellers' (Mannan 1984, p. 237).

• The last alternative in this connection is the **nationalisation of prices.** This means administered prices of the goods and services limited to basic human needs. When other measures are not producing the desired results, an Islamic state has the right to own the means of production and distribute them under the direct supervision and control. The role of market under this scheme is absent. This measure should, however, be undertaken only as a last resort.

According to Mannan, 'In an Islamic economy what is needed is to give a big push for joint action based on the principle of induced and voluntary co-operation, mutual help and sacrifice for the poor so that under-privileged consumers and producers can effectively participate in economic activities of the society' (p. 211).

REFERENCE FOR FURTHER READING[4]

M. A. Mannan (1984).

[4] For details, see the list of references given at the end of the Book.

Chapter 5

FACTORS OF PRODUCTION AND THEIR PRICING FROM AN ISLAMIC PERSPECTIVE

[**Key concepts:** Categorisation of factors of production in Islamic economics – Islamic concept of capital – entrepreneurship – *Mudaraba* business – *Musharaka* business – income distribution – Marginal Productivity Theory of Distribution – Islamic principles of factor pricing – values of average and marginal contributions of labour – effective labour demand curve – collective bargaining]

This chapter aims to identify and define the factors of production, and show how these factors get priced from the viewpoint of an Islamic economy. We begin with the first issue.

1. CATEGORISATION AND DEFINITIONS OF FACTORS OF PRODUCTION

In the traditional economics four factors of production are recognised. As known to the students of elementary economics, these are **land, labour, capital**, and **organisation**. The last factor is also often called **entrepreneurship.** Each of these factors gets its share from the produced goods and services.

Islamic economics neither accepts this categorisation nor agree to their (the so-called) standard definitions. This section is devoted to the categorisation and definitions of the factors of production used in the process of production.

(a) Categorisation

The process of production involves the use of some factors, some are fixed and some are variable. In the real world situations,

both agricultural and non-agricultural goods as well as services are produced. But what are the factors that determine them? As said above, the Islamic economists do not accept the categorisation of traditional economics; but unfortunately they are not unanimous about the categorisation of inputs appropriate in an Islamic perspective. The basic reason behind this difference is that neither the Quran nor the *Sunnah* has made explicit mention about the factors that actually determine the production process.

However, for example, Abu Saud (1965) goes along with the standard intermediate textbook in the west and classifies the factors in the same way as land, labour, capital and entrepreneurship. On the other hand, Shafi (1979) and Mannan (1970) categorise the factors into three. The former drops entrepreneurship and the latter capital from the list of factors of production. Again, Al-Junaid (1992) adds 'human capital', in addition to 'labour' and 'capital goods', as a separate factor of production. There are Islamic economists who want to combine capital and entrepreneurship into one category. This is not acceptable at least for two reasons. First, the share of profit of the provider of capital and that of entrepreneurship can not be the same; they have to be negotiated and decided upon. Secondly, the two factors differ in many respects. The most prominent one is that capital bears the risk, but the entrepreneur does not.

However, as mentioned above, although the Islamic *Shariah* makes no explicit reference to the factors of production, it does provide some hints regarding this. As noted by Sadeq (1992, p. 273), the *Shariah* provides that labour can be hired on a fixed wage and the reusable physical assets (such as buildings, machinery and land) on a fixed rent. It also provides that capital and entrepreneurship will receive predetermined percentages of profits. Therefore, by implication, four factors of production can be recognised from the viewpoint of Islam. These are:

(i) Labour,
(ii) Physical assets,
(iii) Capital, and
(iv) Entrepreneurship.

In the next subsection, an attempt is made to define these factors of production from an Islamic perspective.

(b) Definitions

Like the categorisation, the so-called standard definitions of the factors of production as given by the conventional economists are also not acceptable in Islam. Variations of definitions have arisen for a number of reasons. One obvious one is the analysis of the functional rewards of the factors. In the traditional economics wages go to labour, rent to land, interest to capital and profit to entrepreneurship. But in Islam, interest, a fixed return on capital, is strictly prohibited. However, Islam does not condemn fixed returns on all the components of capital as used in the traditional economics. For instance, such capital goods as buildings and land earn income, but, since they are called rents, they are allowed in Islam. Therefore, the definition of capital will have to be changed to suit the conditions of Islam, rather than omit this factor altogether as done by Mannan. In the following paragraphs the definitions of the factors as identified above are given.

(i) Labour

The definition of labour in Islamic economics is not different from the traditional economics. As a factor of production, it covers human services, physical or mental, that is devoted towards the production of goods or services. This human service may include the blue-collar workers (i.e., the manual workers) or white-collar workers (i.e., the managerial and administrative staffs). The basic distinguishing characteristic of this factor, which distinguishes it from others, particularly from the entrepreneurship, is that a labour receives fixed wages or salary as per contract per unit of time. A person who does not get a predetermined amount of money for his or her work is not included in this category of factor (i.e., labour).

(ii) Physical assets

This factor of production is fundamentally different from the traditional one. In the traditional economics, the factor used is land, which is actually a gift of nature and hence often called 'natural

resource'. Economists have regarded this factor as perfectly inelastic in nature distinguishing it from capital whose elasticity is, to a great extent, elastic; that is, this can be produced when so needed. These traditional views are not, however, altogether true. Land resources known today are not definitely finite. Application of modern inputs may lead to increase in productivity, which implies an increase in the size of land without necessarily an increase in its physical size. Its elasticity is not zero in all cases. The supply of capital (say, machinery) is also not elastic in nature: Its supply, particularly the highly specialised ones, can not be produced within short period in response to demand.

Against this background, Islamic economists have introduced a new factor of production called 'physical assets'. This includes all those reusable material means that can be leased and rented out to be used in the process of production. According to Sadeq (1992, p. 273), this factor may be characterised by one or more of the three intrinsic features. First, it can be a natural resource (termed as land in traditional economics) or produced 'physical' means of production (included in capital in the traditional economics - e.g., a machine). Secondly, it can be used on a rental basis, e.g., a building. Thirdly, it may depreciate after being used for production. Thus the most fundamental feature of the new factor, physical assets, it includes both land (a factor used in the traditional economics) and a part of capital as defined in the traditional economics.

(iii) Capital

The place and definition of capital is very crucial in Islamic economics. In the traditional society, the functional reward of capital is interest, which is prohibited in Islam. In effect this very feature of capital has led some Islamic economists like Mannan to omit it altogether from the list of factors of production in Islamic economic society. However, mere omission of this factor will not negate the crucial role played by this factor in the production process in the modern world. This has led some other Islamic economists to redefine the concept as shown below.

In traditional economics, capital is normally defined as a produced means of production. In the other words of Lipsey (1972, p. 49), capital includes 'all those man-made aids to further production, such as tools, machinery, plant and equipment, including everything man-made which is not consumed for its own sake but which is used in the process of making other goods'. The 'man-made aids to further production' can be divided into 'physical' and 'financial' resources. According to Sadeq, the former is included in the physical assets as defined above and the latter is retained in the concept of 'capital'. In other words, **capital is defined as the financial means of production.** It constitutes liquid money, near money, and monetary assets. The following clarification has been provided.

> 'For all practical purposes, the financial resources, and not the physical materials, are considered as capital. It is well known that the price of capital in traditional economics is interest. Neither an entrepreneur nor an economist calculates interest on a building. What is the interest rate of a building or of a machine? And how does one calculate the interest rate of a building? Is it calculated per square foot? The real practice is different. An entrepreneur takes money from the bank and spends it renting/constructing a building, buying machines, paying the workers, and so on. The bank charges interest on money lent and not on the assets bought by the money. Interest is also charged on money used to make payments to workers, supervisors, and managers, who are not considered as capital. Therefore, in practical uses, money and financial resources are considered as capital' (Sadeq 1992, p. 274).

The clarifications given above would appear to be quite acceptable. This definitely provides scope for thinking of revising the definition of capital even by the modern economists.

(iv) Entrepreneurship

The word 'entrepreneurship' is derived from the French word 'entrepreneur' meaning the one who undertakes tasks. In the conventional economics, 'The entrepreneur is the one who **risks** by introducing both new ways of making old products and wholly new

products.' (Lipsey 1972, p. 50). He is the one who organises land, labour and capital and directs them along new lines.

In Islamic economics, the term 'entrepreneurship' has got almost the same connotation except that **he is not assumed to take the risk of losses in capital.** More specifically, here a distinction is made between the entrepreneur and the ownership of capital. When they are different, the risk is actually born by the owner of the capital and the entrepreneur losses nothing but his labour. This happens in the case of *Mudaraba* and *Musharaka* types of arrangements. Incidentally, under *Mudaraba* arrangement the entire capital is provided by one party and the other (the entrepreneur) bears only the managerial costs and share profits according to the agreed ratio. Under the *Musharaka* arrangement, capital is provided by both the parities and the proportion of the capital provided shares the profit. If, however, the entrepreneur is also the owner of the capital, he can be regarded as a risk-taker in the conventional sense. Thus, this implies that the concept of entrepreneurship is variant to the kind of business an economic organisation is involved in.

2. FACTOR PRICING AND INCOME DISTRIBUTION

Conventionally, the problem of pricing of the factors of production is known as **'distribution'**, or more specifically, **'income distribution'**. This actually refers to the problem of **'for whom'** goods are to be produced. Or, how the income generated is distributed among the factors of production. The pricing of the factors of production helps determine for whom. Before we go on to discuss the mechanism of pricing in an Islamic framework, it will be useful to have some ideas about the shortcomings of the traditional theory. So, we begin to show the factor pricing under traditional economics.

(a) Under Traditional Economics

In the conventional economics, the most popular, and the most celebrated, theory is what is called the **Marginal Productivity**

Theory of Distribution. According to this theory, a productive factor is paid a price equal to its marginal product (hence the name 'Marginal Productivity Theory (MPT)'). In other words, in equilibrium, which is established by the forces of demand and supply, a factor will be rewarded according to its marginal productivity. This otherwise means that the produced goods and services will be distributed among the factors of production in accordance with their marginal products. The essence of the theory is illustrated in Figure 1 with reference to the price of labour, the most dominant factor.

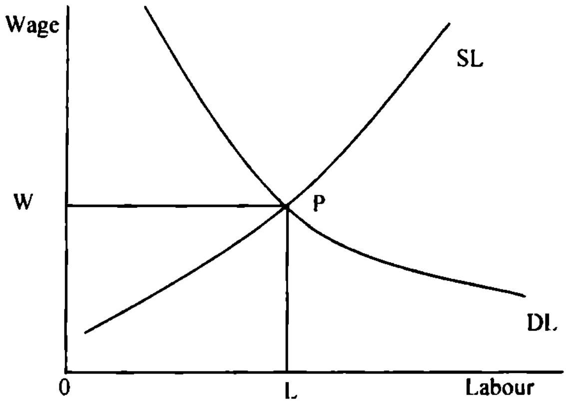

Figure 1: Factor Pricing Under Conventional Economics

Where,

DL = demand for labour derived from the value of marginal products

SL = supply of labour

The two curves intersect at P, which gives wage per unit of labour as OW and amount of labour employed as OL.

This theory has been criticised not only by the Islamic economists but also by the conventional economists. The main ones are.

Firstly, it assumes a production function of homogeneity of degree one, which is rare in the practical world.

Secondly, the MPT assumes perfect competition in the factor market where all economic powers are in fact fragmented. It can not discriminate between sexes and social classes. In the practical world, collective bargaining through trade unions is common in all industries, public or private: this reality is ignored by this theory.

Thirdly, profit maximisation is assumed. But in reality a firm may consider many alternative objectives such as sales maximisation or maximisation of social goals.

Finally, the MPT does not deal with the remuneration of the entrepreneurs, although this may constitute non-negligible proportion of total national product of any country.

Thus, the traditional MPT would appear to be highly inadequate for determining the prices of the productive factors. This is particularly so because of the fact that it ignores such vital aspects as collective bargaining, social conventions and minimum wage legislation. This theory can at best be treated as a guide for fixing the prices of the factors involved in the production factors.

(b) Under Islamic Economics

Before we go on to discuss the factor pricing in an Islamic perspective, let us say a few words about the Islamic principles of factor pricing and income distribution.

Principles of Factor Pricing

In Islamic economics, three principles, more specifically, 'normative' principles, are applied in pricing the productive factors of production. These are:

- justice
- scarcity, and
- humanity

Justice: In effect justice as a principle is universal in the world of Islam. Truly speaking, the basic purpose of revealing the Quran is to establish justice in the society. As it says, **'We send our messengers with the Book and the Balance, so that mankind may**

establish justice' [Hadid 57:25]. In another place the Quran dictates, **'That man can have nothing but what he strives for' [Najm 53:39].** These two injunctions, when combined, imply that with regard to factor pricing, this justice is maintained when each factor is priced according to its contribution **(but what he strives for)**. Since Islam does not approve **exact equality** among men, this principle is rephrased as 'fix the price of a factor in such a way that it **corresponds** to the factor's contribution ------ . The closer , however, the price is to contribution, the closer it is to justice' (See Sadeq, p. 276). This principle sets the lower limit of the prices to be set for the factor prices.

Scarcity: The word 'scarcity' simply means that man generally has unlimited material wants but the resources by means of which to satisfy those wants are scarce, i.e., land is limited in supply. This implies that if a factor is scarce, it is natural that its price will be high. This pertains to the interplay of demand and supply. Islamic economists are well aware of this and demand that the interplay should be within the reasonably acceptable range of justice. Some Islamic economists (e.g. Kahf 1992, p. 115), are of the view that the economic problem is not one of scarcity in relation to needs but is caused by human laziness and neglect in the extraction of the full benefits of Allah's gifts in terms of both human and natural resources. This laziness and neglect is called 'oppression' or 'cruelty' in the Quran. **[see Ibrahim 14: 32-36].** One Hadith says, 'Ask Allah to help and do not feel incapable, for nothing is impossible' **(Muslim).** However, the limited supply of any factor sets the upper limit of its price.

Humanity: This principle is particularly relevant to the pricing of the labour. Biologically, labour is an inseparable attribute of mankind. It can not be purchased and sold like a commodity: The man in question has to take his being to the workplace in order to render his service. This **human service** gives rise to some special

considerations which are not very relevant for the other productive factors of production. Firstly, 'those are your brethren whom Allah has made under you', a *Hadith* from **Bukhari,** implies that there is a need for a brotherly relationship between an employer and an employee. Secondly, the workload and the working conditions should be humanly acceptable. Note that there may not be any time limit for other factors such as a machine. Thirdly, the humanity principle also implies that the amount of wages, *ceteris paribus,* should be sufficient to meet the basic needs of the employees.

Principles of Income Distribution

In Islamic economics, the principle of income distribution is clear and categorical. According to the Quran, **'To men is allotted what they earn and to women what they earn'** [Nisa 4:32]. Again, in another place it says, **'In order that it (wealth) may not (merely) make a circuit between the wealthy among you' [Hashr 59:7].** These two injunctions when taken together implies that Islam recognises the differences among the people in terms of skill, efforts, health, and intellectual capabilities and their impacts on earnings but at the same time it urges that there must not be any gross inequalities of income and wealth among the people.

Factor pricing

We shall now discuss how prices of the productive factors of production are determined following the principles of justice, scarcity and humanity. It should be understood that, unlike the pure positive economics, the objective here is not to provide perfect theory but to provide some value-loaded guidelines for determining the prices. The discussion is basically drawn from Sadeq and follows the sequence of factors as identified in section 1 above.

Pricing of labour

We have mentioned as many as three Islamic principles which should govern the fixation of price of a factor of production.

Interestingly, all these principles do not lead the wage rate to one direction. The principle of justice implies that the wage rate, assuming a labour-abundant country, should be on the high side so that they are not deprived of the minimum living standard. The scarcity principle, on the other hand, implies that since the labour is abundant, the price should be as low as possible. It is in this type of situation that the third principle i.e., humanity comes and strengthens the contribution aspect of the factor. This does not mean that in Islamic economics the traditional role of market forces is completely ignored. What it means here is that whenever there is a conflict between the normative principles and the market forces, the former will be given preference.

Against this background, we may pass on to discuss the pricing mechanism from an Islamic perspective. Following Sadeq, the discussion is preceded by the following assumptions:

a) an employer strives to earn an average rate of profit from his investment;
b) there is a constant return to scale i.e., an average rate of return from employment; and
c) wage depends both on the subjective (justice and humanity) and objective (market forces) factors.

The last assumption implies that in an Islamic economy, there will not be a unique wage rate, rather there will be a range of wages. In other words, there will be an upper limit and a lower limit. The upper limit will be determined by the **value of the average contribution of labour (VACL)**. This VACL is defined as the total contribution of labour divided by the quantity of labour. This should be distinguished from the **value of average product**, which is defined as the value of total product divided by the quantity of labour. In measuring the VACL, only the contribution of labour is considered, that is, net of the contribution of all other factors of production employed in the production process. When the wage rate is determined by the value of average contribution of labour, the VACL works as the labour demand curve. If SL represents the supply of

labour curve, the intersection between VACL and SL gives the equilibrium wage rate.

The lower limit, on the other hand, is determined by the **value of marginal contribution of labour (VMCL)** which should be distinguished from the conventional concept of **marginal value product** i.e., marginal physical product multiplied by the market price. Like VACL, this contribution is again net of contributions of all other factors of production. If the wage rate is determined by the value of marginal contribution, the VMCL works as the corresponding labour demand curve. Geometrically speaking, when this downward-sloping labour demand curve intersects with the upward-sloping labour supply curve (SL), this gives equilibrium wage rate.

Thus, we have the range of wages, the upper limit is given by the intersection of the VACL and SL and the lower limit is given by the intersection of the VMCL and the SL. Incidentally, the former goes in favour of the employees and the latter to the employer. These are in effect the results of interplay of the two principles, justice and scarcity, operating in opposite directions. Now, we shall show how the actual price of labour i.e., wage, is settled in an Islamic framework.

It is already said that when justice and scarcity pull the wage rate in opposite directions, the humanity principle comes to rescue in an Islamic economy. The application of the humanity principle will depend upon the altruistic behaviour of the employer. If the humanity principle is given the due significance it deserves, the employer in question will tend to give higher wages than what is obtained by the intersection of the VMCL and SL. On the other hand, if this principle does not work at all the wage rate will be very near to this rate. Thus based on humanity consideration we can think of another labour demand curve, which would lie between VACL and VMCL. This curve may be called the **effective labour demand curve (ELDC).** When this curve intersects the SL curve we have equilibrium wage rate which is acceptable in Islamic economics.

The above analysis can now be demonstrated in terms of diagram. Figure 2 gives the necessary information:

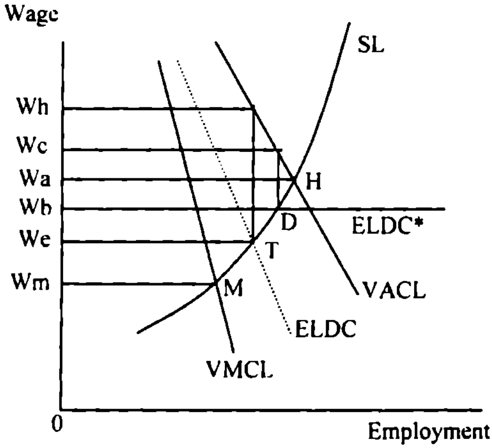

Figure 2: Determination of Wage in an Islamic Economy: A General Case

Where,

VACL = labour demand curve based on the value of the average contribution of labour

VMCL = labour demand curve based on the value of the marginal contribution of labour

ELDC = effective labour demand curve based on the humanity principle which lies between the VACL and VMCL

SL = supply of labour curve

Wm = lower range of wage rate obtained by the intersection of VMCL and SL curves

Wa = upper range of wage rate obtained by the intersection of the VACL and SL curves

We = (Islamically acceptable) equilibrium wage rate obtained by the intersection of the ELDC and SL curves.

Thus, We, the equilibrium wage rate lies between the two extreme prices i.e., VACL and VMCL. At this equilibrium wage rate, the firm earns a profit of We Wh out of per unit contribution of labour.

Role of collective bargaining: So far we have ignored the role of collective barraging in the determination of the price of labour. In the free economy collective bargaining plays a very dominant role in fixing the price of labour. This also may be true in an Islamic economy if the wage rate is so fixed as not to take any consideration of the cost of living of the labour. However, whenever the question of strong collective barraging through trade union comes into the picture, its impact will be to shift the ELDC upwards so that there results a higher equilibrium wage rate.

Let us suppose that the demand for the trade unions is to meet their basic needs. In effect, in an Islamic economy, it will be moral duty and responsibility on the part of the employer or the government to meet the basic needs of the employees i.e., food, clothing, shelter, education, and medication. Let us also assume that this minimum demand is Wb as indicated in the diagram. An Islamic state is under obligation to meet this minimum wage rate. If accepted the ELDC becomes ELDC* which when intersects the SL gives a wage rate at Wb. If this wage is given, the employer still gets a profit of WbWa. It should be noted that a wage rate up to Wa (at VACL) will not be acceptable even in the eye of Islam, because this will affect the efforts of the employees. However, if the wage rate based on the average cost of living is not sufficient to meet the basic needs of the employees, then it will be necessary to pay the balance out of social funds accumulated through *Zakat* and contributions of the relatively rich people.

The case of less developed countries: The situation of less developed countries characterised by the abundant supply of labourers need a special treatment. In these countries the labourers are terribly exploited by the employers. The Readymade Garments Industries in

Bangladesh may be cited as an ideal example. In these industries, the labourers, particularly, the unskilled ones, are very often paid wages even less than the minimum wages identified above with aid of VMCL curve. Pricing of labour in these countries is described with the help of a diagram as follows.

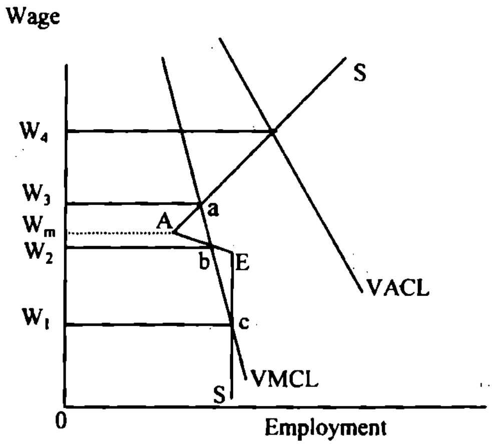

Figure 3: Determination of Wage in an Islamic Economy: The Case of Least Developed Countries

In Figure 3, we assume that SAES is the labour supply curve. It has three segments. The segment, SA, is the normal supply curve i.e., it slopes upwards from left to right implying that the higher wage rate higher will be the supply of labour. AE is backward bending. This implies that when the wage rate is so poor that the employees can not even meet their basic needs, they work longer hours so that they can get some extra money and somehow can manage their family. This actually shows that lower the wage rate higher is the supply of labour. The last segment, ES, is a vertical line, which means that whatever may be the wages, the supply of labour remains constant. This actually shows because of the physical limitation of man, they can not work beyond this line.

Let us assume that Wm is the minimum wage, which is required by the employees in order to meet their basic needs. In Figure 3, it is seen that the labour supply curve, cuts the VMCL curve at three points, a, b, and c. It depends on the attitude of the employer whether he would pay a wage obtained at a or b or c. A profit-maximising firm will certainly pay the wage rate that will maximise its profit: this happens at the point where the VMCL curve cuts of labour cuts the vertical segment of the supply curve.

In an Islamic economy the employing firm can be made to pay a wage in the range between W3 - W4 which lies on the upward portion of the supply curve as given in the diagram. The exact wage will, of course, depend upon:

* moral standards of the employers
* the strength of the collective bargaining, and
* the presence and the effectiveness of minimum wage legislation of the state.

The employment effect of the pricing system under Islamic economics will be positive. This will happen simply because the ELDC or ELDC* would lie on the right of the VMCL but below the VACL.

The distributional effect will also be favourable. As in Islamic economics, the real wages of the labourers will be higher than that of the traditional economy.

Pricing of physical assets

It should be remembered that the term physical assets include both the reusable and the rentable assets. Particularly the inclusion of such capital as machinery is important. It is also important to note that pricing of the factor may involve the pricing of the physical asset itself or the prices of its services. Obviously, the latter is more relevant in the present context.

Since the financial component of the capital is not included here and the humanity element can be ignored, determination of its price becomes straightforward. The traditional forces of demand and supply can determine its price. Note that, according to the *Shariah*, a

pre-fixed price of the services of the physical assets is allowed in Islam, and it is called **rent.** For example, a machine or a building can easily be rented out at a fixed price (rent). This fixed return is legitimate even if the user incurs losses during the process of production. Moreover, since the human element is ignored, the question of legislative floor pricing may not arise at all. Thus the prices of the physical assets can very well be determined by the forces of demand and supply as illustrated in Figure 4.

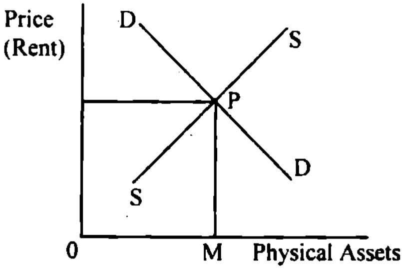

Figure 4: Pricing of Physical Assets

Pricing of capital and entrepreneurship

In traditional economics, interest is treated as the price of capital. We have said over and over again that interest is not allowed in Islam. We have argued above that it is unjustified to add capital and entrepreneurship together as they imply two different things in the process of production. But, on the same logic, can the prices of these factors be decided separately in Islamic economics? The answer is clearly 'no'. This is because in Islamic economics, capital (the owner of) and entrepreneur (the person who provides the entrepreneurial services) share profit in the same activity. If the share of one partner is known the other partner's share is automatic (provided that there are only two partners). Incidentally, the prices of these two factors are defined as sales revenues minus all costs and payments made to all other factors including labour and physical assets. Since the sizes of prices of these factors can not be predetermined we only consider the sharing of the prices, that is, profit, which can be determined *ex ante.*

The principle of sharing profits and losses depends upon the form of business. At least two forms of business can be discussed here. These are *Mudaraba* and *Musharaka.* in the former form of business, one partner (say, the Islamic bank) provides the entire capital and the other partner provides the necessary entrepreneurial services. Profit is distributed according the pre-agreed ratio. The loss, if any, is borne by the provider of capital, and the entrepreneur's services go unrewarded. In the case of the latter form of business, both the parties share profit and loss according to the pre-agreed ratios.

Fixation of prices under *Mudaraba* business: Under the *Mudaraba* system, the traditional forces of demand and supply determine the share of profit. However, in the present context the two terms, demand and supply, will have different connotations. Here demand is defined as the **demand-adjusted for productivity (DAP)** and the supply is defined as the **supply-adjusted for scarcity (SAS).** The fixation of prices (in effect sharing of profits) of these two factors is shown in terms of diagram as follows.

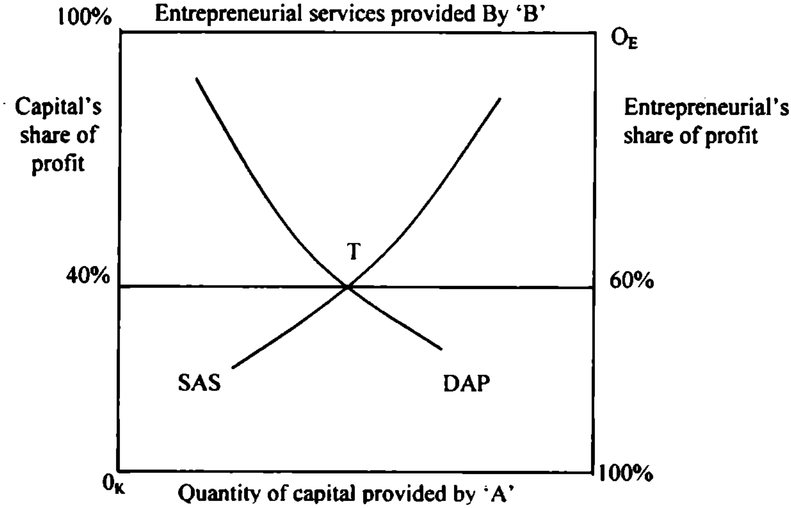

Figure 5: *Ex ante* Determination of Profit Shares in *Mudaraba* Business

For simplicity, we assume there are only two partners, A and B. In Figure 5, actually a box, the lower horizontal axis measures the quantity of capital as provided by A. The upper horizontal axis (mind it, not shown by Sadeq!) measures the entrepreneurial services provided by B. The left-hand side vertical line shows the share of profit of partner A and that of the other side of the same box shows the share of profit of the entrepreneur. DAP and SAS curves show, respectively, productivity-adjusted demand curve and scarcity-adjusted supply curve. The downward sloping demand curve for capital implies that the quantity demanded for capital increases as capital's share of profit falls, and the upward sloping supply curve implies that the quantity of capital supplied increases as the capital's share of profit increases, of course, in percentage terms in both the cases. The two curves intersect at T which simultaneously determines the share of A, as a provider of capital, and the share of B, the provider of entrepreneurial services. According to our diagram, the equilibrium point shows that the share of profit is 40 per cent for A and that of B is the remainder, i.e., 60 per cent. As said above, if the firm incurs loss, this will be borne by the provider of capital. Hence, there is no need to deal with it in the case of *Mudaraba* arrangement.

Fixation of price under *Musharakah* business: Under the *Musharaka* business, all the parties involved in the business share capital. Like the previous form of business, the factor pricing is again based on profit sharing. Islamic economists differ regarding the basis of profit sharing in this case. In effect, there are two schools of thoughts. According to the Shafi and Maliki Schools of jurisprudence, it is more justified to share profits according to the partners' contribution to capital. In other words, if one partner contributes 30 per cent share of the total capital, he should receive 30 per cent of the profit accrued to the business. On the other hand, according to the Hanafi and Hanbali Schools of jurisprudence, it is more justified to share profits among the partners according to their organisational and entrepreneurial services. This implies that the partners may negotiate

and decide about profit sharing in percentage terms irrespective of their contributions in the total capital. this can be illustrated with the help of a diagram below.

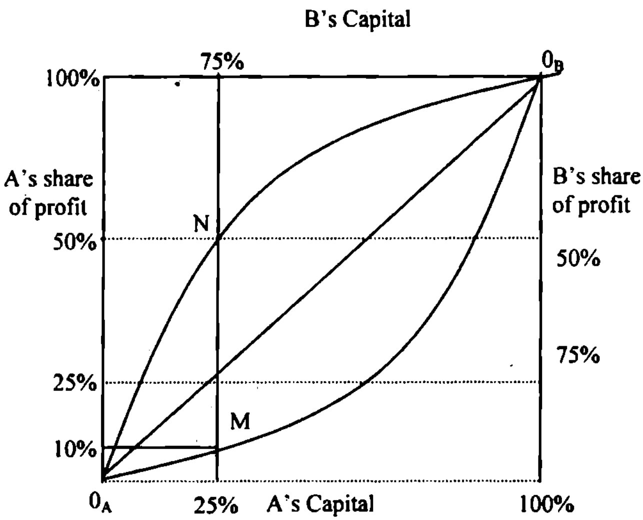

Figure 6: *Ex ante* Determination of Profit Shares in *Musharaka* Business

In Figure 6, we assume there are only two partners. In the box, the lower and the upper horizontal axes represent the contribution of capital of partner A and partner B, respectively. The left and right hand vertical axes show the shares of profit going to partner A and partner B, respectively. All information are in percentage terms, the measuring scale is the same for both the partners. We can now show how the share is fixed according to the two opinions noted above.

According to the first opinion, the distribution line is given by the 45-degree straight line running from left to right. Shares falling on this line imply equality in the percentage of capital and profits. Let us suppose that A contributes 25 per cent of capital (along A's capital axis, lower horizontal axis) which corresponds to 25 per cent share of profit for A along A's profit axis (left vertical axis). This

simultaneously indicates that the contribution of capital of B is 75 per cent along B's capital axis so that he receives 75 per cent of profit along his profit axis (right vertical axis). The example can be repeated for any other share of capital with the help of the diagram.

The pattern of distribution of profit may be different when the opinion of the second school of thought is considered. Since the share of capital and that of profit do not correspond in this case, the distribution line may take any shape varying from the 45-degree straight line to any curvature above or below the straight line. If the share of A is larger, the distribution curve will lie above the straight line and vice-versa. For example, if the distribution curve is above the straight line, say, O_ANO_B, then partner A will get 50 per cent share of profits by contributing only 25 per cent of the capital, while he gets only 10 per cent profit by contributing the same proportion of capital, if the distribution cuṙve becomes O_AMO_B.

The mechanism of sharing losses is interesting. It should be noted that under the *Musharaka* business, the loss is distributed according the share of capital. this implies that the share of entrepreneurial services goes unrewarded. In terms of our diagram, the 45-degree straight line can explain this. That is, the loss is divided between A and B according to their contribution in the share of capital, just like the distribution of profit according the first school of thought as described above.

The pattern of income distribution in both the forms of business as discussed above would be equitable because each party receives the share of profits on the basis of their contribution in the production process. None gets fixed share, as in the case of traditional distribution system, a fixed share (+ve or -ve) irrespective of the size of the profit.

3. SOME OBSERVATIONS

The above analysis is basically drawn from Sadeq. His categorisation of the productive factors would appear quite

acceptable. The new definitions of capital and physical assets are interesting and may provide good insight for further discussion even by the modern economists. The mechanisms for fixing prices for the inputs identified, although very theoretical may serve as a basis for further study. Some observation may however be made as follows.

Firstly, the analysis is based on the assumption that there is a constant return to scale, which is not the normal picture in reality. In particular, this assumption can not be accepted for agricultural farms, where the diminishing return is a rule rather than an exception.

Secondly, the new concept VACL will be difficult to measure in practice. Sadeq is of course appears to be quite aware of this difficulty.

Thirdly, the analysis has not dealt with the institutional framework that will be required to implement the normative principles of factor pricing and income distribution as discussed above.

REFERENCE FOR FURTHER READING[1]

A.H.M. Sadeq (1992)

[1] For details, see list of the references given at the end of the Book.

Chapter 6

TOWARDS A THEORY OF ISLAMIC FIRM

[**Key Concepts:** Islamic firm – Islamic entrepreneur - right of Islamic ownership – Islamic civil laws – profit maximisation – sales maximisation – satisficing – full-cost-pricing – 'good deeds' – constrained utility maximisation – minimum acceptable level of profit - marginal rate of substitution]

This chapter makes an attempt to deal with those points that are essential for developing a theory of Islamic firm and show the contributions made so far by the Islamic economists towards building the theory. In particular, the meaning and characteristics of an Islamic firm and the process of decision-making vis-à-vis the conventional firm are discussed. The discussion on the categorisation and measurement of various factors of production and their pricing is presented in a separate chapter.

1. CHARACTERITICS OF AN ISLAMIC FIRM

Ordinarily, an **Islamic firm** is defined as that firm which is governed by the Islamic norms. More technically, a firm will be called Islamic when 'it is ruled by Islamic laws that are enforced by both civil laws and religious beliefs' (Metwally 1992, p.131). This will be clear from the following section.

An Islamic firm will have the following characteristics.

(a) Islamic Right of Ownership

An Islamic firm will have firm belief in the right of ownership as per Islamic instructions. In Islamic economics literature, the right

of ownership is defined in a special way. The basic characteristics of the right of ownership, as expounded by Kahf (1992, p. 118) are as follows.

(i) Not absolute but limited

In Islam, the property is treated as a trust, the true owner being Allah Himself. This characteristic owes directly to the Quran which says that all things between the skies and the earth belong to Allah **[Baqara 2:284]**. That is, Allah, not any human being, is the **absolute** owner of everything. Man, however, as a vicegerent of Allah **[Baqara 2:30]** has been subjected to use everything between the skies and the earth **[Lukman 31:20]**. The right to property is, therefore, not absolute but limited and qualified.

(ii) Purposive

Even the limited rights of ownership are neither devoid of any purpose nor an end in itself. Wealth is a means to an end of living a life in accordance with Allah's guidance and of earning a reward in the Hereafter.

(iii) Accessible to all mankind

In Islam, it is presumed that all human beings are members of one family, which implies, among other things, that the bounties of nature and worldly goods should be made accessible to all mankind, that is, they do not become monopoly of a few.

(iv) Full economic utilisation

The object of the right of property is nothing but the opportunity of full economic utilisation. If this opportunity is not adhered to, the Islamic states has the authority to reduce the right of ownership, even to zero depending upon the proportion of 'oppression' committed. This does not mean that Islam accepts excessive penalty. 'There should be no harm, neither injury'.

(v) Limited to lifetime:

The right of ownership over one's property is limited in time by the life of the owner. The principles of distribution of property after one's death are clearly stated in the Laws of Inheritance.

(b) Islamic Civil Laws

The basic objective of the Islamic civil laws is to promote productivity and, more particularly, discourage idleness or non-utilisation of resources. In effect, as stated by al-Sadr (see Kahf 1992, p. 113), the extraction of every particle of usefulness from the entire universe is an ideological objective of the Islamic society. Some examples originally designed by him are given below:

(i) The government will take land away from the private owner if he does not till it and abstains from cultivating and using it. The state will not pay any compensation and will dispose of the land to the best of its judgement.

(ii) Acquisition of ownerless land does not establish the right to ownership of it; what it does is the proper utilisation of it. Colonisation of land is a source of ownership in Islam under four conditions:

- Non-existence of any previous claim of ownership;
- Continuous productive use of it;
- Non-use of others' labour, even if it is paid for in the process of colonisation; and
- Non-violation of the principle of equal opportunity.

(iii) Non-privately owned natural resources are to be left unused. Non-use of them results in the invalidation of the private claim on them.

(iv) Public land may be given to private bodies only in accordance with their capability of utilisation.

(v) All kinds of non-productive intermediary activities are prohibited, such as leasing a piece of land at a certain rate and renting it at a higher rate.

(vi) Economically non-productive activities such as gambling, the practice of magic, and sorcery are prohibited.

(vii) The state has a leading role to play in production in relation to planning and public enterprise. It is allowed to obtain resources and redistribute them in order to maximise the realisation of the normative objective of the society.

(c) Islamic Pattern of Consumption

An Islamic firm will not be guided by the existing consumption pattern of conventional consumers. The firm knows that an Islamic consumer has to abide by certain restrictions imposed by the Islamic *Shariah*. Therefore, it would not participate in the production or sale of alcoholic drinks, the production and sale of pigs, gambling, etc. Also prohibited are all types of industrial activities and relations which degrade the human being or make him party to voices for the sake of gain. Thus, the Prophet prohibited certain forms of economic activity, such as prostitution and the income generated by it.

Again, Islam believes in equal distribution of income and wealth in the society. The firm is aware that the demand for essential items will have to be met first. This will then be followed by convenient and, finally, luxury items. Therefore, an Islamic firm will give more emphasis on the production of essential goods and services.

(d) Islamic Business Norms

If the firm in question is a business firm it should be guided by the following norms:

(i) The firm will not adopt deceptive market strategies such as short measure or weight while selling and long measure or weight while buying. This guideline is directly derived from the Quran. That is: **'Woe unto those who give short measure, those who, when they take by measure from other people, take it full, when they give by measure to others or weight out to them, they give them less. Don't such people know that they will be raised again unto a terrible day, the day when mankind will stand before the Lord of the worlds?'[Tatfif 83:2-7].** The Muslim business firm should, therefore, try to do justice in measuring and weighing as far as humanly possible.

(ii) This injunction, among others, implies that an Islamic firm must refrain from the use of deceptive advertising and other deceptive market strategies which could be used to expand its market share or raise the price of its products. If the product has got any defect however negligible it must be brought to the notice of the customer.

(iii) 'The holder of a monopoly is a sinner and offender' (***Hadith***). That is, unguarded monopoly creates barriers to entry into the market. Therefore, an Islamic firm must avoid that market strategy, which result in the creation of barriers to entry and give rise to monopoly.

(iv) 'Allah will bless the tolerant and lenient man who sells, buys and takes his dues nicely and gently' (*Hadith*). This implies that an Islamic firm must follow 'fair rules' in all its dealings while acting as a buyer or seller of goods and services.

(v) Islam prohibits any trade that involves injustice, cheating, or promotion of something which is *Haram* .It is unlawful to do business in alcoholic beverages, intoxicants, drugs, swine, idols, statues, or anything of this sort whose consumption and use Islam has prohibited. Islam prevents the selling of even *Halal* item such as grapes, if it is known that the buyers will use them to make wine (Qaradawi 1960, p. 130). He is required to sell good and bad items, if any, separately. The Prophet says, 'Sell the good and bad separately. He who deceives us is not of us'.

(vi) An Islamic firm must avoid all acts of exploitation, discrimination, and restrictive trade practices, since all these are denounced by Islamic principles.

(e) Islamic Entrepreneurship

(i) An Islamic entrepreneur is engaged in business activated by the relatively impersonal motive of fulfilling his obligation as a **trustee**. He is not guided by the principle of self-interest as in the traditional economy.

(ii) This suggests that an Islamic entrepreneur's objective will **not be profit maximisation** and that he may be satisfied by realising what is called a **reasonable or fair** level of profit.

(iii) Accumulation of wealth without the consideration of the other members of the society he belongs to will not be the sole objective. He is aware of the Quranic instruction: **'Wealth and children are an ornament of life of the world. But the good deeds which endure are better in thy Lord's sight for reward, and better in respect of hope' [Kahf 18:46].**

(iv) Another important characteristic of an Islamic entrepreneur is that his decision to save is closely linked to his decision to invest. This implies that in Islamic economics, the economic agents are not allowed to keep their surplus resources idle. They will have to utilise the fund for productive activities.

(v) Perhaps, the most important characteristic of an Islamic entrepreneur is that his behaviour needs to be guided by the consideration of **altruism** i.e., concern for others.

(f) Nature of Equilibrium

The conventional firms aim at maximising profit. In other words, profit maximisation is the only objective that a conventional firm strives to achieve. This is attained at the point where MR= MC and the former curve cuts the latter from below. This is the equilibrium point. In contrast, Islamic firm has no such unique equilibrium situation. In effect, it may come about any one of the following four situations (see Figure 1).

Situation (1): MC = MR at maximum profit level: OQ_3
Situation (2): MC = MR at minimum profit level : OQ_1
Situation (3): MC > MR at medium profit level : OQ_2
Situation (4): MC < MR at negative profit level: OQ_4

These situations are demonstrated in terms of a diagram as appeared in Figure 1.

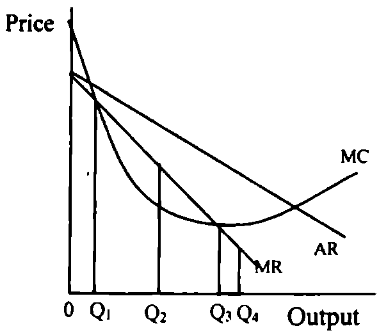

Figure 1: The firm at different profit-output levels

Situation (1) represents the standard textbook type equilibrium. It satisfies both the necessary condition (MR=MC) and sufficient condition (MC cuts the MR curve from below) of equilibrium. In the diagram, this equilibrium point is established at the output OQ_3. In an Islamic economy, this type of equilibrium is not unacceptable: it can be regarded as a special case. The firm in question may belong to both public and private sectors.

Situation (2) is unacceptable in the traditional economy because, it satisfies the necessary condition but not the sufficient one. In the case of Islamic economy, particularly in the public sector, it represents a probable case. The firm under certain circumstances (if it is producing essential goods and services) may have to be satisfied with minimum profit with output level as OQ_1. This is possible only when the firm in question has altruistic behaviour.

Situation (3) represents a situation that lies between maximum and minimum profit levels. Output level OQ_2 may be an example in point. Truly speaking, this is the level that is more practical than the maximum profit level. It can very well represent the situation of an Islamic firm.

Situation (4) represents a situation where the firm is earning negative profit (output OQ_4). Although for traditional economy this situation would be considered as completely unacceptable, an Islamic economist would not discard this situation altogether. Under special circumstances, particularly for the production of essential goods like food and medicine, Islamic government may have to incur losses. Negative profit level can be thought of only for the public sector. That the government may go on producing even if the profit becomes negative mainly on the consideration of poor and distressed people. This is actually subsidy given to the poor. Like situation (1), this should also be regarded as a special case, perhaps, a very special case.

Thus in the Islamic world, the equilibrium of the firm can not be unique in the sense that the different firms may opt for different output levels depending upon their perception of values and motivation.

As a concluding remark on the equilibrium condition, it may be noted that an Islamic firm may have to produce an output when only the necessary condition is satisfied. There are Islamic economists (like Mannan) who advocate for full-cost principle as an alternative to MR-MC principle. This principle implies that the firms in an economy use available data to compute full costs per unit (variable costs plus overheads) and add to this a conventional **mark-up**; price is set at this figure and sales are determined by what the market will clear at this price. If the market-clearing price is beyond the reach of the common people, a subsidy may be given, if it is considered appropriate from social point of view. Here the firms are conceived of as having a perfectly elastic supply curve at the level of full cost. It is not difficult to establish that this full cost principle leads to different prediction than does profit maximising theory.

(g) Objectives

The behaviour of an Islamic firm can not be guided by a single objective. It may so happen that it may have to give up the notion of maximising anything, profits, sales, or anything else. While deciding WHAT, HOW and FOR WHOM a production is to be made, an Islamic firm would ask: what contribution the output is going to make for the benefit of the people?

(i) Profit maximisation

As said above an Islamic firm will not necessarily aim at maximisation of profit.

(ii) Sales maximisation

Sales maximisation is another thing that is considered by conventional theory as an objective of producer firm. It refers to maximisation of gross sales revenue. This does not mean the maximisation of physical volume of sales but rather maximisation of money value of sales i.e., price times quantity. The standard rule that is applied to determine the maximum volume of sales is: '....maximum

revenue is obtained only at an output at which the elasticity of demand is unity i.e. at which marginal revenue is zero' (Baumol 1964, p. 376). Here the elasticity of demand is unity as against the profit-maximising theory, which implies that elasticity is greater than unity.

This theory is based on the assumption that it is the managers rather than shareholders that really control the firm. It is also presumed that the managers need to make some minimum level of profits to keep the shareholders satisfied; after that they are free to seek growth unhampered by profit considerations.

This theory is not acceptable in Islam at least for two reasons. As, according to Mannan (1992, p.125), firstly, the notion of profit constraint, as noted above, may provide an effective barrier to sales maximisation; and, secondly, sales maximisation may become possible without maximisation of total revenue sales. The latter may be illustrated by the fact that the firm in question may decide to sell his products (say, production and distribution of fertilisers to poor farmers) at a near zero price considering its significant social welfare implications. These are illustrated in Figure 2.

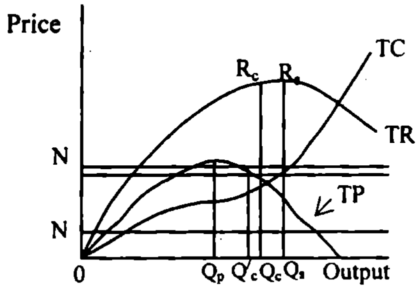

Figure 2: Output Decision of an Islamic Firm Showing its Conflict with the Profit- and Sales-Maximisation Outputs in the Market Economy

Where,

TC = total cost
TR = total revenue
TP = total profit

OQ_1= profit-maximising output
OQ_2= sales-maximising output
OQ_0= socially desirable output

Sales maximising output is OQ_2 i.e., at the point where TR is maximum. This level of output is very much consistent with the minimum level of profit i.e., ON. Profit-maximising output is OQ_1, which is attained, by definition, where the gap between the TR and TC is the largest. Now suppose that the socially desirable output is neither the OQ_1 nor the OQ_2, rather it is somewhere in between, say, OQ_O. This new level of output immediately comes in conflict the profit-maximising level of output OQ_1 that is smaller than the socially desirable output. Again, this new level of output introduces implicitly the profit constraint ON_0 that is surely not compatible with or insufficient for sales-maximising output. Clearly, this has implications for resource allocation in an Islamic economy.

(iii) Satisfying

Satisfying is another alternative theory of the firm's motivation. According to Herbert Simon, 'We must expect the firm's goals to be not maximising profits but attaining a certain level or rate of profit, holding a certain share of the market or a certain level of sales'. The underlying theme of this theory is that firms will strive very hard to achieve a certain **minimum** (or 'target') level of profits, but, having achieved them, they will not strive aggressively to improve position further. This also means that the firm could come to rest in a large number of situations rather than in only one unique situation (the profit maximising or sales maximising).

According to Mannan, although the behaviour of an Islamic firm would appear to come very close to 'satisfying motivation', yet there are differences in underlying economic rationale and economic philosophy. In the market economy the overriding concern is economic factors, whilst in the Islamic economy the overriding concern is ethical and moral imperatives.

Thus, it possible to have any of the four equilibrium situations in an Islamic economy. In other words, the behaviour of an Islamic

firm can not be guided by a single objective. This may vary from firm to firm depending on the nature of their operations, demand conditions and welfare implications. The actual decision may also depend on the pattern of ownership control and distribution of income. The overall behaviour of the Islamic firm must however be consistent with the Islamic principles of balanced and harmonious development of moral and material development of the society.

2. TOWARDS A THEORY OF ISLAMIC FIRM ('METWALLY MODEL')

By reading the Islamic economics literature it appears that the work done in this area, so far, is very little and it will perhaps take some time to have a well developed Islamic theory of firm. What follows is the contribution made by Mewally (1992) in this regard. His model is called **'Behavioural Model of Islamic Firm'.**

(a) The Basic Philosophy of the Model

The whole philosophy of the Metwally-model centres round the Quranic injunction: **'And spend out something (in Charity) out of the substance which We have bestowed on you, before death should come to any of you and he should say, 'O my Lord! why didst Thou not give me respite for a little while? I should then have given (largely) in charity and I should have been one of the doers of good' [Al-Munafiqun 63:10].** He points out that the doing of Good Deeds (*'amal salihin*) is mentioned as many as 62 times in 36 *Surahs* (out of 114) of the Quran.

The implication of the Quranic instruction as quoted above is that the owners, managers, and other personnel of an Islamic firm would have one major object: spending on charity or good deeds. What does 'Good Deeds' means in economics? According to Metwally, this takes:

> 'Many forms from direct payment to the poor and needy in the community to expansion in numbers employed by the firm beyond the level warranted by profit maximisation, simply to contribute

towards solving the problem of unemployment (if it exists) and thus alleviating the burden of unemployed. More frequently, good deeds may take form of building hospitals and schools to cater for the relatively poor sections of the Muslim community; building mosques to promote Islam and maintain the Islamic ideology; and spending to help the poor and the needy, to fight in the cause of God, to spread Islam, and to promote continually its teachings and applications' (Ibid. p. 132-33).

This implies that the main objective of an Islamic firm should be to do good deeds. Being a business an Islamic firm must also be able to realise a 'reasonable' level of profit to maintain its business, and if it is a public corporation, it must be able to distribute annually a 'reasonable' level of profits to its share-holders. The essence of the model is stated in following words. 'The Islamic firm would seek the maximisation of a utility function which is a function of the amount of profits and the amount of spending on charity or good deeds subject to the constraint that the amount of profits would, after the payment of all imposed taxes (*Zakat* and other dues), be no less than a minimum level which is 'safe' to keep the firm in business.' (Ibid. p.133).

(b) Mathematical Presentation of the Model

The model can be explained in terms of mathematics as follows.

Let the utility function of an Islamic firm is given by:

$$Y = Y(G, F) \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad (1)$$

Where,

Y = utility
G = good deeds or charity
F = level of profits

Again, the level of profit is composed of:

$$F = M - Z - U \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad (2)$$

Where,

M = actual level profit
Z = amount of tax of *Zakat* paid on profits
U = amount of additional dues paid on profits

Again, all the terms of (2) are composed of:

$$M = R - C - G \quad \ldots \quad \ldots \quad \ldots \quad (3)$$

$$Z = \mu M = \mu (R - C - G) \quad \ldots\ldots \quad (4)$$
$$U = \beta M = \beta (R - C - G) \quad \ldots\ldots \quad (5)$$

Where,

R = total revenue

C = total cost

μ = the rate of *Zakat*

β = the rate of other dues

Again,

$R = pq$

Where,

p = price per unit

q = quantity produced

It is assumed that:

$\delta p/\delta q < 0$, i.e. the demand curve is negatively sloped

$\delta p/\delta G > 0$, i.e. charity expenditure helps increase in the demand for firm's product

Now substituting (3), (4), and (5) in to (2) we have

$$F = (R - C - G) - \mu(R - C - G) - \beta(R - C - G)$$
$$\text{Or,} \quad = (1 - \mu - \beta)(R - C - G) \quad \ldots \quad \ldots\ldots \quad (6)$$

Against this background, the constrained maximisation function of an Islamic firm can now be stated thus:

$$\text{Maximise } Y = Y(G, F)\ q, G$$
$$\text{Subject to } \phi = \pi - F \leq 0 \ \ldots\ldots \quad \ldots\ldots \quad \ldots\ldots \quad (7)$$

where π represents a minimum acceptable level of profit to satisfy its owners and its business.

Metwally solved the above maximisation problem with the help of Kuhn-Tucker conditions and arrives at the following results:

(i) $(\delta R/\delta q - \delta C/\delta q) = 0$

or, $MR - MC = 0$

or, $MR = MC$

(ii) $\delta R/\delta G = 1 - Y_G/Y_F\ (1/(1 - \mu - \beta)$

or $\delta R/\delta G = 1 - \{r_{G,F} / (1 - \mu - \beta)\}$

where,

MR = marginal revenue

MC = marginal cost

$r_{G,F} = Y_G/Y_F$ = marginal rate of substitution (MRS) between expenditure on charity or good deeds and distributed profits.

(c) Interpretation of the Results

These two results satisfy both the necessary and sufficient Kuhn-Tucker conditions. In addition to these conditions, Islamic teachings clearly require that the MRS should diminish between any two goals and that the marginal utility of any single goal should also diminish.

Result (i) suggests that the equilibrium of an Islamic firm requires that MR = MC. This is the same condition as we find in the case of conventional firm. However, although condition is the same in the traditional and Islamic firms the output level at which the condition holds may not be the same. Metwalley shows that the output level of the Islamic firm is higher than that of the traditional firm. Its explanation is simple. Note that in the case of an Islamic firm, $\delta R/\delta q$ is implicitly a function of G (expenditure on good deeds). Figure 3 demonstrates that an Islamic firm with similar cost structure will have a higher equilibrium output and equilibrium price than in the case of traditional firm.

Here, DD′ represents the demand curve in the traditional firm. dd' represents the demand curve of an Islamic firm. dd′ reflects the assumption that in an Islamic economy, $\delta p/\delta G > 0$. For the Islamic firm, the equilibrium level of output q_1 is higher than the q_o, the output level of traditional firm. The price level is also higher in the case of an Islamic firm.

Result (ii) suggests that in an Islamic economy, the proportion of revenue devoted to good deeds will depend upon the MRS between distributed profits and good deeds ($r_{G,F}$) as well as on the rates of *Zakat* and other dues. The higher the rate of dues on undistributed profits, the less will be the proportion of revenue devoted to good deeds. This is not unreasonable, since it will be assumed that higher dues would be collected for the purpose of achieving higher levels of good deeds by the Muslim authorities. It may be added that in a traditional firm, ($r_{G,F}$)=0, and thus the only necessary condition for optimisation is that MR= MC.

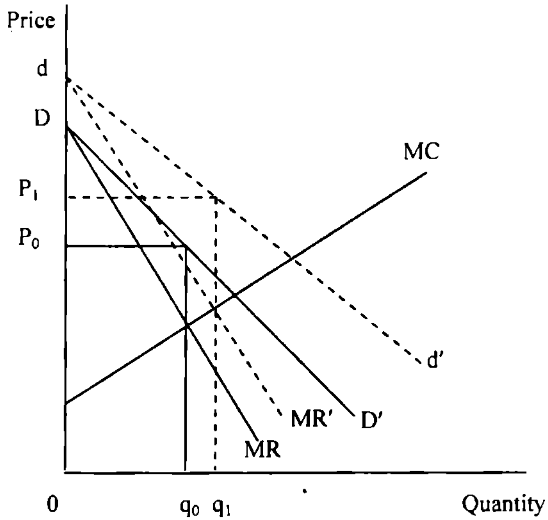

Figure 3: Equilibrium of Islamic and Non-Islamic Firms

(d) Concluding Remarks

Metwally is perhaps one of the very few Islamic economists who have incorporated Quranic dictates into the theory of firm and that too in the mathematical language. The mathematical derivation seen in the model may open the door for incorporating some other socio-moral variables into the mathematical models. However, we shall have to go further. Estimable equations will have to be developed, functional forms will have to be chosen, the relevant variables will have to be identified and quantified and ultimately employ them to the real world data.

REFERENCES FOR FURTHER READING[1]

1. M. A. Mannan (1984), 2. M. M. Metwally (1992), 3. Monzer Kahf (1992).

[1] For details, see the list of references given at the end of the Book.

Chapter 7

MARKET STRUCTURE IN AN ISLAMIC PERSPECTIVE

[**Key concepts:** perfect competition – marginal cost – marginal revenue – equilibrium conditions – full cost pricing – mark up – monopoly: natural, artificial, Islamic – monopsonist – price differentiation – oligopoly – duopoly – kinked demand curve – informative and educative advertising]

In the conventional economics basically two types of markets are analysed. These are perfectly competitive market and imperfect market. Under the latter monopoly and oligopoly are very prominent. This chapter is devoted to an analysis of the market structure with special reference to an Islamic economy.

1. PERFECT COMPETITION

(a) Traditional Theory

We begin with perfect competition. The elementary intermediate students of economics know that a profit-maximising firm has to fulfil three conditions. These are:

(1) For a given output to be profit-maximising output, it is necessary that total revenue (TR) is equal to or greater than total variable costs (TVC).

(2) For a given output to be the profit-maximising output, it is necessary that at that output MC (marginal cost) = MR (marginal revenue).

(3) For a given output to be the profit-maximising output, it is necessary that for slightly smaller outputs MR>MC, and that for slightly larger outputs MC>MR.

This is illustrated in Figure 1 below. The geometric interpretation of condition (2) is that the profit-maximising output must be at the point where the MR and MC curves intersect, and of condition (3) is that the MC curve should cut the MR curve from below. Figure 1 shows that MR=MC at two points. Output OQ_2 is a profit-maximising output because, as output is increased up to OQ_2, each unit is adding more to revenue than to cost, while beyond OQ_2, each successive unit is adding more to cost than to revenue. On the basis of the same argument, it is possible to show that output OQ_1 is a profit-minimising output, i.e., profits are falling as output rises to OQ_1 and rising as output increases beyond OQ_1.

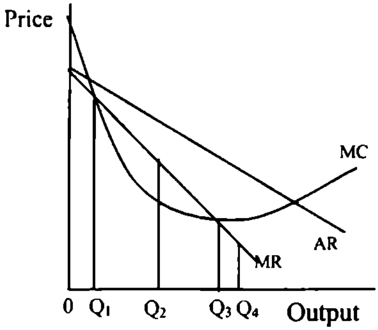

Figure 1: The Firm Showing Necessary and Sufficient Conditions for Profit Maximisation

(b) Some Comments from an Islamic Perspective

What does it mean to firm's behaviour in the Islamic society? In the Islamic economy, the firm may have to produce an output in which only the necessary condition for maximum is satisfied. Of course, it is not unethical if the firm may decide to produce an output where the sufficient condition is also satisfied. In an Islamic economy, a firm under the public sector may have to produce an output at a **negative** profit level where MC > MR, keeping in view the existing dimension of poverty of the country.

If MR-MC mechanism is not satisfactory, what is the alternative? The most popular alternative is what is known as **full cost pricing.** According to Mannan, this theory may be more relevant to the Islamic firm. This principle implies that the firms in an Islamic economy use available data to compute full costs per unit (variable costs plus overheads) and add to this a conventional **mark up;** price is set at this figure and sales are determined by what the market will clear at this price. If the market-clearing price is beyond the reach of the common people, a subsidy may be given, if it is considered appropriate from social viewpoint. Here the firms are conceived of as having a perfectly elastic supply curve at the level of full cost. It is not difficult to establish that this full cost principle leads to different prediction than does profit maximising theory.

2. MONOPOLY

(a) What is Monopoly?

By 'Monopoly' we generally mean control over the supply, and, hence, control over the price of a product as well. In a perfect monopoly, there is only one producer of a particular product and that the commodity has no close substitutes. Unlike competitive firm, he is not bound to take the market price as given. In effect, given his objective to maximise profit, he can either fix the price or let the buyers decide the quantity or he can fix the volume of sales and wait to see the price offered by the buyers. He can not control both.

(b) What is the Attitude of Islam Towards Monopoly?

Technically speaking, monopoly may be of two types namely, **natural monopoly** and **artificial monopoly.** There are certain goods and services, which by nature can not normally be supplied by too many persons/companies. These are provided by one or very few persons. Supply of electricity or gas or special herbal medicine is some examples in point. Persons dealing with the supply of these types of commodities may be called 'natural monopolists'. Islam does

not deny their existence subject to certain restrictions in their dealings. There are certain persons, on the other hand, who artificially become monopolists by resorting to asocial means. For example, hoarding of essential goods and services during crisis period by a single person and selling those at prices much higher than the normal prices. This is evident from the *Hadith*: 'If any one withholds grain for forty days out of the desire for a high price, Allah will renounce him.' Islam is against this type of monopolist.

(c) Distinction Between an Islamic Monopolist and a Conventional Monopolist

The behaviour of an **Islamic monopolist** would be different from that of a **conventional monopolist.** This can be shown as under.

First, an Islamic monopolist will not consider maximisation of profit as the **only** objective of his business. Instead, he may consider 'satisfying profits' rather than 'maximum possible profit' as one of the basic objectives of his business.

Second, the prices charged by an Islamic monopolist would be lower and that would be comparable with the price in the competitive market.

Third, the volume of sales would be higher for an Islamic monopolist when compared with conventional monopolist.

(d) Price-Quantity Relationships

(i) Under conventional economics

One important point about a monopolist is that the prices charged by him are always higher and outputs offered are always smaller when compared with the competitive firm. Explanation is simple. In the case of the competitive firm, average revenue (AR), marginal revenue (MR) and demand curves coincide and are represented by a horizontal line. Equilibrium is established at the point at which MR= MC and the latter cuts the former from below. In contrast, in the case of monopoly, AR, or demand curve, is not horizontal, rather slopes downward from left to right. When

equilibrium is established at the intersection of the MR and MC curves, price automatically becomes higher and the quantity sold smaller when compared with the competitive firm.

If the monopolist also becomes a **monopsonist**. i.e., he is the only buyer of certain inputs, his power becomes double: in this case he can also manipulate his cost of production according to his sweet will.

From any standard textbook, one can see relationship between price and quantity in a monopoly market as depicted in Figure 2.

where,

AR = average revenue curve (= demand curve)
MR = marginal revenue curve
MC = marginal cost curve
P = Price (equilibrium)
q = quantity supplied

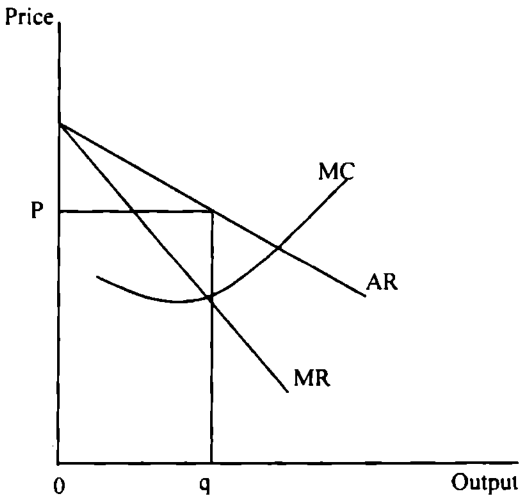

Figure 2: Equilibrium of a Monopoly Market

(ii) Islamic dimension

It is of crucial importance to note that under monopoly, the equilibrium as shown above is not unique. Here the equilibrium is established at the point where MR is equal to MC; but, unlike perfect competition, it (MR) is not equal to price. In other words, under monopoly, MC is not equated to price; it is rather, as can be seen from the diagram, much lower than the price. From these conditions Lipsey (1975) inferred that 'it is possible for different demand conditions to give rise to the same output but to differing prices.' In effect, when a firm faces a downward-sloping demand curve, there is no unique relation between price and quantity. Mannan (1984: Chapter 11) has expanded this idea as can be seen in the following two diagrams.

SAME OUTPUT BUT TWO DIFFERENT PRICES

Figure 3 illustrates two different demand curves, D_1 and D_2, same output and two different prices. When demand is D_1, marginal revenue is MR_1. Equilibrium is established at the point where MR_1 is equal to MC. This gives quantity at OQ_1 and price OP_2. Again, when demand is D_2, marginal revenue is MR_2. Equilibrium is established at the point where MR_2=MC_2. Here the output remains the same but the price is different i.e., OP_2. Thus, it is possible to the have same output sold at different prices under monopoly situation.

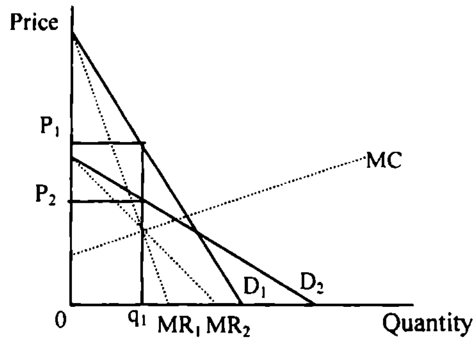

Figure 3: Monopoly Market Showing Two Different Prices Associated with the Same Output

SAME PRICE BUT TWO DIFFERENT OUTPUTS

In Figure 4, it is shown that it is possible to have a situation where we have the same price but have various outputs. That is, when demand is D_3, we have marginal revenue as MR_3 and marginal costs MC_3. Equilibrium output is OQ_3 and the price is OP_3. Again when demand is D4, marginal revenue is MR4 and marginal cost is MC_4, equilibrium output is OQ_4. but the price remains the same i.e., OP_3.

The above analysis has clear Islamic dimensions. According to Mannan, 'Since the monopolist faces the downward-sloping demand curve, he may be induced to sell the same output at different prices or increase output at the same prices by assigning weights to the consumer's surplus either through Islamic orientation or through legal cover, thereby urging monopolists to adopt a public utility pricing principle, particularly in favour of the low-income group or people living below the poverty line.' (1992, p.178). The normal rule by which price is related to marginal cost under monopoly becomes:

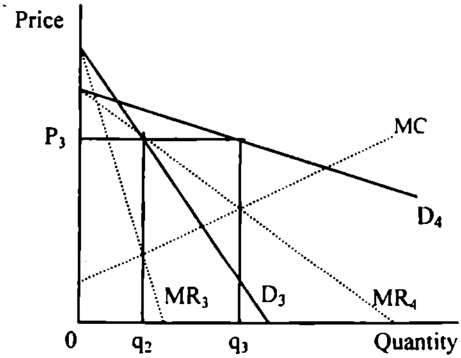

Figure 4: Monopoly Market Showing Two Different Outputs Associated with the Same Price

$$P = MC \frac{e}{v + (e - 1)}.$$

where,

P = price
MC = marginal cost
e = price elasticity of demand
v = weight

From the above equation, it can be shown that when v=0, we have a normal monopoly situation i.e., price becomes equal to MC times e upon 1-e. It can also be shown that when v=1, price and MC become equal. Where interests of different groups must be weighted, individuals may differ in their assessment. According to Mannan, 'We cannot entirely depend on economic analysis, a political process is involved' (p. 265).

(e) Is Price Differentiation Permissible in Islam?

First a few words about the terminology. In the standard economic textbook, the phrase **'price discrimination'** is used. Truly speaking, the word 'discrimination' has a bad reputation and connotation to many, and, therefore, in the Islamic economics literature this phrase is replaced by **'price differentiation'** meaning 'price discrimination in its operational aspect' (Mannan 1984, p. 179). The difference between these two phrases lies in its objectives and emphasis. Given the maldistribution of resources in the society, the basic objective of price differentiation, unlike price discrimination, is to ensure an **equitable** price to all and hence maximisation of social welfare is emphasised. Defined in this way, price differentiation is very much permissible in Islam. Mannan has given many examples where this sort of price differentiation is permissible. We mention only two just for illustration.

Example 1: In many Muslim countries, there exist disparities in income among different regions. An internal transport company in such a country charges different prices for different regions depending on their relative backwardness.

Example 2: Suppose an electrical company started selling electricity more cheaply to those industries which are devoted to the

production of basic needs of the community than to the luxury-goods industries.

The way the firm in question may charge different prices to different groups of customers can be shown in terms of diagram as follows.

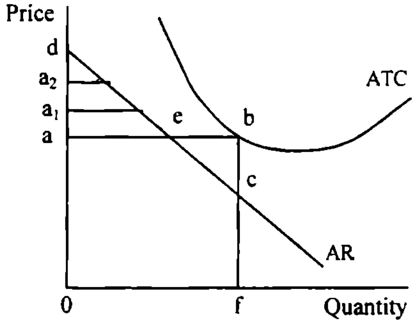

Figure 5: A Set of Differential Prices Covering Costs

Where

ATC = Average total cost
AR = Average revenue (demand curve)

Here the total cost is OA (quantity) x AB (= OP, price) i.e., OABP. Total revenue is OA x OC i.e., OAEC. Whether OAEC (total revenue) will be greater than OABP (total cost) will depend upon the difference between the triangle PCD (revenue earned due to higher price) and DEB (the revenue lost due to lower price). As long as long the former is greater than the latter, there are profits.

It is important to note that if each block can be sold at a set price, then MR of selling an additional block is the price of that block. Here MR is no longer less than price as in the case of a normal monopolist. Thus in the case of price differentiating monopolist, the demand curve becomes the MR curve and the controlled monopolist reaches equilibrium at the point where P=MR=MC, the picture that one gets in the case of perfect competition. But this is equivalent to

perfect competition. The present competitive equilibrium, unlike perfect competition, actually offers an equitable price, taking into consideration the level of income and its distribution. It has a grater appeal to the Islamic system.

The above analysis, therefore, shows that if price differentiation (planned price discrimination), is properly supervised and planned, can very well be used to achieve the goal of an Islamic economy.

3. OLIGOPOLY

(a) What is Oligopoly?

Oligopoly stands between perfect competition and pure monopoly. According to Chamberlin, oligopoly (and duopoly) is defined as those cases 'where the number of sellers in a market is greater than one, yet not great enough to render negligible the influence of any one of them upon the market price' (Chamberlin 1950, P. 39). When the number of sellers is exactly two, the market is called **duopoly,** so that the oligopoly is characterised by the number of sellers as greater than two. Another characteristic of oligopoly is that as the number is small, it is possible for the seller to observe the policies of the others, calculate the possible repercussions upon his own sales, and make his own policies accordingly. Still another characteristic of this type of market is that entry of new firms is either not possible, or too difficult. Due to these characteristics, the oligopolistic market comes very close to the monopoly market in certain respects.

(b) Determination of Price and Output

Under oligopoly, it is not possible to determine the price and output in the same manner as in the case of perfect competition or monopoly. 'The source of the problem is the fact that oligopolistic arrangements are notoriously undependable' (Baumal 1968, p. 330).

The firm's policy here depends upon how it **thinks** its rivals will react to its move, and the outcome of the firm's policy depends upon how they **do** in fact react. There is no set rules for the equilibrium price and output.

This does not, however, mean that the price and output are indeterminate in an oligopolistic market. The factors which actually help determine the price and output is the 'competitors' **real** and **imaginary** reactions to each other's behaviour'.

This has, therefore, led the theoreticians to form several hypotheses regarding oligopolistic behaviour. One such hypothesis, which has Islamic dimension, is what is called the **Kinked Demand Curve.** This is discussed below.

(c) Oligopoly and Islamic Dimension: The Case of Kinky Demand Curve

This can be explained with the help of Figure 6. In this figure, as usual, the x-axis and y-axis measure price and quantity, respectively. Let us assume that C represents the firm's current price-quantity combination, i.e. OP (=QC) is the price and OQ is the quantity demanded. This can happen either through the shape of the DD′ demand curve or the dd′ demand curve. The issue before us is to examine the impact of changes in the price from this situation. Two types of effects are anticipated:

(i) Price reductions

If the firm in question reduces its price and expects that the other competitive firms (whose number is very few) would not follow suit, it reap the benefit of larger sales. However, having known this price cut the other firms also reduce their prices and the firm in question faces a steeper (inelastic) demand curve i.e. the lower portion of the DD` demand curve.

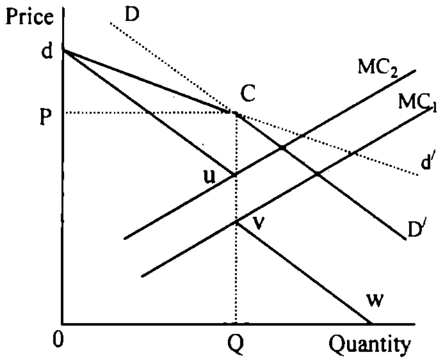

Figure 6: Oligopoly Market: The Case of Kinked Demand Curve

(ii) Price increases

When the firm decides to raise its price, the other firms do not co-operate. In this case the firm will face a demand curve which is rather elastic in character. The upper segment of the dd′ curve represents this situation.

All these show that the demand curve through the point C is not a continuous line, but rather has a kink at point C. The new demand curve dCD′ is hence called **Kinky Demand Curve**. For this demand curve, it is possible to draw the corresponding MR and MC cost curves as shown in the figure. dUVW (kinked) is the MR curve and MC_1 and MC_2 are marginal cost curves.

This kinked demand curve suggests that the firm in question does not gain either by reducing the price (other firms do the same) or by raising it (other firms do not follow). In either case his profit gets reduced. Therefore, on the demand side, there is good reason to believe that prices under oligopoly tend to be inflexible or ‘sticky’. Again, from the cost side, the broken MR curve indicates that within limits, there will be no significant change in cost as shown by the movements of the MC curves between U and V. Cutting of MC curves anywhere along the vertical segment of the MR curve causes no impact either on price (OP) or on quantity (OQ). This implies that

under the oligopolistic market, it is possible to introduce an element of stabilisation of price and hence may ensure real income at least to the working class.

Herein lies an Islamic dimension. If through Islamic orientation or through appropriate institutional arrangements the basic feature of kinked demand curve is retained, this will bring good to the society. If, however, it so happens that the oligopolists resort to non-price competition, this may still be accepted in Islam if the non-price competition is reflected in the programme of minimisation of wastage, or in the improvement in the quality of the product.

4. ADVERTISING (Is it permissible in Islam?)

In the present day, advertising has evolved into an industry. It plays a dominant role in creating demand for goods and services. In particular, when the products are new, there is always a fear in the minds of the producers that the products they are producing may not have a market, given the pattern of income distribution and stability of tastes. Advertising comes to the rescue in the situation. In effect, advertising has a direct bearing on the behaviour of a firm.

Under the free market system, advertisement very often becomes too glamorous, wasteful and even aggressive. Its contents are often imprecise and untrue. The qualities of the products highlighted in the advertisement also conceal harmful or negative aspects of the products. This in effect creates artificial barrier to entry into the specific commodity market.

This unholy act is sustained in the capitalist economy by a series of interlocking arrangements. The producers are to pay a very high price for advertisement which helps the media sustain. The producers either directly or through the intermediaries shift the whole advertising expenditure on the shoulder of the consumers. So the consumers are forced to finance the advertising expenditure without their consents.

In Islam, advertising is neither condemned, nor accepted in a very high esteem. While the aggressive advertisement intended to manipulate the demand for the product is clearly against the principles of Islam, **informative advertising** intended for **educating the customers** is very much within the Islamic norms. The introduction of new techniques and products has been possible through advertising.

In Islamic economics, the basic principles of advertising are as follows. First, Advertising information will not resort to false oaths, incorrect weights and measures and hence ultimately create 'bad will' in the business world. This has its origin in the Quran. The Quran says, **'Woe unto those who give short measure, those who, when they take by measure from other people, take it full, when they give by measure to others or weight out to them, they give them less. Don't such people know that they will be raised again unto a terrible day, the day when mankind will stand before the Lord of the worlds?'[Tatfif 83:2-7].** The Prophet also prohibited sellers from promoting sales by false vows. He made it the responsibility of the seller to inform the buyer about the negative aspects of product **(Muslim).** Thus, advertising information must contain both hard and cold facts about the product.

Secondly, Islam does not allow that advertisement which lead to artificial barriers to entry and helps earn abnormal profit at the cost of the masses.

Thirdly, on the positive side, advertisement expenditure should be directed to educate the customers as well as the producers by the supply of correct market information about the quantity, price and quality of the goods and services concerned.

In an Islamic economy, advertising expenditure can, if properly handled, create demand and hence can increase the volume of sales, of course, up to an acceptable level of profit. The following diagram illustrates the point we are going to make.

From Figure 7, it can be seen that under perfect competition, a profit-maximising firm will push its advertising expenditure up to the point where maximum profit is attained. In the diagram, this happens at point B. That is, when his advertising expenditure is OB, he attains maximum profit i.e., BD. The Islamic firm does not strive to attain the

maximum profit, but must maintain a minimum level of profit in order to run his business. It is assumed that the line PC (called profit constraint) represents this level of profit. Under this assumption the firm may push his advertising expenditure up to OE. Interestingly, at this point his volume of sales would be much larger than that of the non-Islamic firm.

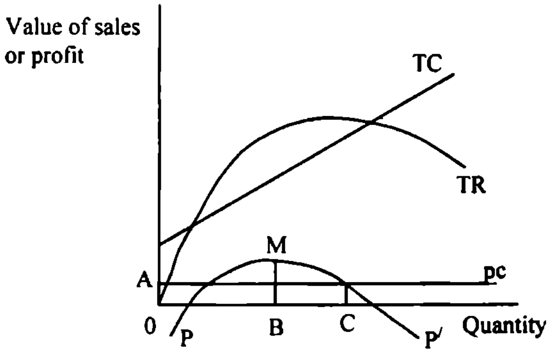

Figure 7: Advertising Expenditure

Here,
TC = Total cost including advertising expenditure
TR = Total revenue
PC = Level of minimum acceptable profit
PP′ = Total profit

If the firm wants to maximise its profit, the advertising cost will be OB and the profit BM. But if the firm wants to maximise its sale, the advertising cost will be OC and the profit OA.

REFERENCES FOR FURTHER READING[1]

1. W. J. Baumol (1964), 2. M. A. Mannan (1984).

[1] For details, see the list of references given at the end of the Book.

PART - III

MACROECONOMICS

'AND WHEN THE PRAYER IS ENDED, THEN DISPERSE IN THE LAND AND SEEK OF ALLAH'S BOUNTY, AND REMEMBER ALLAH MUCH, THAT YE MAY BE SUCCESSFUL' [JAMUA 62:10].

Chapter 8

THEORY OF ISLAMIC CONSUMPTION FUNCTION

[**Key concepts:** Keynesian consumption function – marginal propensity to consume – permanent income hypothesis – life cycle hypothesis – actually needed consumption – expected desirable income – spending in the way of Allah]

1. SOME COMMENTS ON THE CONVENTIONAL CONSUMPTION FUNCTIONS

In the conventional economics, the **Keynesian consumption function** is the most popular one. According to this theory, consumption depends on income. Symbolically,

$$C = f(Y)$$

or, expressed in linear form,

$$C = a + bY$$

Where,

C = current consumption

Y = current total or disposable income

a = constant, and

b = coefficient of income, interpreted as **Marginal Propensity to Consume**

The essence of the theory is that when income increases consumption also increases but not as much as the increase in income. In terms of diagram, the Kenesian consumption function is shown in Figure 1.

This theory has been criticised even by the conventional economists. The criticism centres mainly on the definition of income. It is said that people do not necessarily make their consumption on the

basis of current income. This view has led to several other theories of consumption function. The most notable ones are **Permanent Income Hypothesis** developed by Professor Friedman and **Life-Cycle Hypothesis** developed by Professor Modigliani and others. According to the former, consumption depends not on current income but on **permanent income**. The latter, on the other hand, says that household's make their consumption decision on the basis of the income expected to be earned over their **lifetime.**

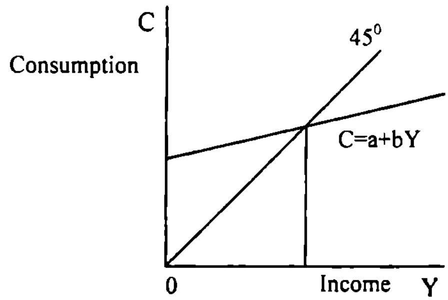

Figure 1: Kenesian Consumption Function

From the point of view of Islamic economics, the following observations can be made:

Firstly, **'And in their wealth the beggar and the outcast had due share' [Zariyat 51:19].** In economic terminology, this Quranic injunction implies what is called 'minimum provisioning' for the poor. This actually refers to basic needs including food, shelter, clothing, basic education and health care. This otherwise also means that there should be a provision of minimum level of income for the consumers. The traditional consumption functions as stated above do not make any such provision for the poorer section of the community.

Secondly, the consumption functions consider only income on which consumption depends. In the real world situations, particularly in the Islamic world, host of other factors including transfer payments such as *Zakat* may also play an important role.

2. THEORY OF ISLAMIC CONSUMPTION FUNCTIONS

This section attempts to show the development towards building a theory of Islamic consumption function. A number of contributions are available in the Islamic economics literature notably by Mannan (1984) and Ausaf Ahmad (1987). These contributions are now discussed.

(a) Contribution of Mannan (1984)[1]

(i) Islamic Dimension in the Kenesian Consumption Function

Mannan begins with the Kenesian consumption functions as mentioned above and tries to offer Islamic interpretations to them. When the function is $C = bY$ (i.e. without any intercept term), this implies that if income is zero, consumption would be zero. This is not acceptable in Islam because consumers are not allowed to have zero consumption at least when the question of basic needs arises. It is the moral duty of the relatively rich people and the state to provide them with the minimum basket of goods and services. When the consumption function becomes $C = a + bY$, following the same logic, he says that the intercept term 'a' can be given an Islamic interpretation. The constant term (which is assumed to be positive for essential goods and services) 'a' implies that when income is zero, the household can still spend the amount indicated by the constant. According to Mannan, the household can spend this amount either 'by consuming past saving or by borrowing. If neither is available, it is the responsibility of the community to provide the basic minimum level of living.' (p. 290).

(ii) Variables of the Islamic Consumption Function

According to Mannan, consumption does not necessarily depends upon income alone, it depends upon host of other factors. The variables as suggested by Mannan are as follows:

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[1] While presenting the contribution, in many places additions and subtractions have been made. The author remains responsible for any mistake occurred due to this in the presentation.

C = f(Y, I, H, V, Z, S)

The definitions and the significance of the variables are given below:

C = Consumption. This consumption is not defined as current consumption as in the conventional theories; this is defined as **'actually needed current consumption expenditure'**. This has its root in the Quran: **'And in their wealth the beggar and the outcast had due share' [Zariyat 51:19].** This in effect refers to the minimum level of consumption required by a family for maintaining a minimum standard of living. In this sense savings is defined as disposable income minus actually needed consumption expenditure.

Y = Income. Given the definition of consumption, income here does not refer to total or disposable income as defined in the conventional textbook. This refers to **'expected desirable income'** which means the income that the household **expects to earn and expects to receive from others or to give others on a continuous basis.** This concept of income differs from permanent income or life cycle income that the households expect to earn over a period of time.

I = Intra-family consumption level/obligations. This follows from the Islamic principle that an Islamic man must make an effort to earn his livelihood and try to fulfil his obligations towards other members of his extended family, neighbourhood and community at large.

H = Horizontal consumption level of his own group of people in the neighbourhood. This variable has the same root as preceding one.

V = Vertical consumption level of income group below and above his own group. In support of this variable, a *Hadith* may be cited. 'Look at those who are inferior to you and do not look at those who are superior to you, for, that is more liable to keep you from despising Allah's favour to you' **(Mishkat).**

Z = *Zakat.* This is rooted in the Quran. As it says, **'Establish *Salat* and pay *Zakat*' [Baqara 2:44].** This is an obligatory transfer payment on the part of a Muslim consumer having the *Nisab* income. That the level of consumption is affected by the payment of *Zakat* is completely ignored by the conventional economists.

S = *Sadaqah.* This is also rooted in the Quran. It says, **'And spend something (in charity) out of the substance which We bestowed on you, before death.....' [Munafiqun 63:10].** Like *Zakat,* the conventional economists also ignore this factor.

It is now possible to determine the influence of each and every variable on consumption.

(iii) Average and Marginal Propensities: Impact of *Zakat*

Average Propensity to Consume (APC) is defined as APC= C/Y (where C= consumption and Y= total income or disposable income). The marginal propensity to consume (MPC) is nothing but the ratio of change in consumption to the change in income. That is: MPC = $\Delta C/\Delta Y$. Similarly, marginal propensity to save (MPS) measures the relation between change in saving and change in income. That is: MPS = $\Delta S/\Delta Y$.

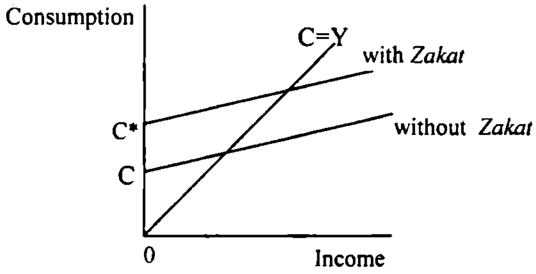

Figure 2: Effect of *Zakat* on Consumption Function

In an Islamic economy, these concepts are not value neutral. One of the goals here is to structure the system of taxes and transfer payments in the form of *Zakat* and *Sadaqa.* Mannan shows the following relationships between *Zakat,* other transfer payments and the average and marginal propensities as follows:

- The MPC and APC of those who receive *Zakat* tend to go up in the short run.
- The MPC and APC of those who pay *Zakat* are most likely to remain constant despite of reduced disposable income.

• The effect of *Zakat* will be very pronounced to the left of the break-even level of income at which APC = 1. APC becomes equal to 1 at the point where the consumption curve crosses the 45-degree line. This implies that the intercept will shift from OC to OC* (see Figure 1).

• Experience suggests that men are disposed on the average to increase their consumption as their income increases but not by as much as the increase in their income. This means that those who receive *Zakat* and other transfer payments may not spend all they receive.

• In the long run it does not necessarily follow that MPC will decline as result of *Zakat*.

(iv) Expected desirable income and consumption

The understanding of expected desirable income hypothesis is very important in evolving the Islamic consumption function. Once this hypothesis is accepted, this would imply that consumption no longer depends on the current income. In an Islamic economy conscious efforts are made to ensure fair and equitable provision for all including the disabled and the weak not merely through the voluntary social welfare measures but through obligatory payment of *Zakat* and other dues imposed by Islam on the rich members of the society. This is a Quranic dictate i.e. **'Wealth should not be permitted to circulate among the wealthy only' [Hashr 59:7].** The Islamic concept of expected desirable income stream is illustrated in Figure 3.

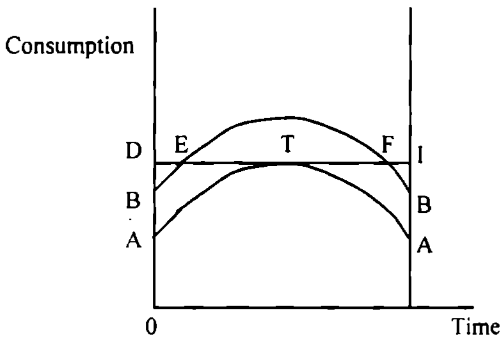

Figure 3: Islamic Concept of Disposable Income

Let us suppose that there are two households, A and B, and that they know their expected earning over a long period of time. AA and BB in Figure 3 show the actual incomes of these two households. These incomes first rise and then fall and finally cease on retirement. Let us also assume that the line DI represents the socially desirable income. From the figure, it is seen that both these households are unable to meet their needed consumption with their actual income. Household B has gap DEB at the early period and IFB at the latter part of the life. Household A has at various stages much bigger gaps, ATD (on the left) and ITA (on the right). These income gaps are expected to be met through various transfer payments as insisted by Islam. Incidentally, this income is not merely a necessary income but also a sufficient income to meet the actually consumption expenditure. Since the actual consumption expenditure ought to be related to expected desirable income stream, the concept of actual consumption in Islamic economics has also a different meaning. In the true sense of the term 'it refers to the actual flows of consumption of the goods and services that **households buy and ought to buy and not to buy,** even if the level of current income does not permit'. (Ibid. p. 299).

(v) Some observations

The merits of Mannan's approach to build up a macro consumption function are that it has rightly criticised the traditional Keynesian consumption function and has added interesting interpretation of the intercept term of this function. It has added Islamic dimensions to the consumption function. Of particular importance are incorporation of *Zakat, Sadaqa* and other transfer payments into the framework. The attempt to define desirable income is praiseworthy. The demerit of this approach is that it provided no further analysis of his function. Its functional forms, collection and measurement of variables have not been dealt with.

(b) Contribution of Ausaf Ahmad (1987)[2]

In his study on *Income Determination in an Islamic Economy*, Ausaf Ahmad has attempted to formulate a theory of Islamic

[2] The materials of this section are based on the Ausaf Ahmad (1992), originally published in 1987.

consumption function. In this attempt, he defines two types of consumption functions namely, consumption function for the *Zakat* and *Infaq* payers and consumption function for the *Zakat* and *infaq* recipients. The Arabic word '*infaq*' actually refers to '*ifaq-fi-sabil-Allah*' which means 'spending in the way of Allah'.[3] Adding these functions he also arrives at the aggregate consumption function for the economy as a whole. In the following paragraphs are described the basic features of his model.

(i) Consumption function for the *Zakat* and *Infaq* payers

This is shown as follows:

$$C_1 = a + bY_1$$

$$\text{or, } C_1 = a + b(Y - Z - I)$$

Where,

$Y_1 = Y - Z - I$

$Z = zY$

$I = rY$

C_1 = aggregate consumption expenditure of *Zakat* and *Infaq* payers

Y_1 = net disposable income of *Zakat* and *Infaq* payers

Y = gross income

Z = *Zakat* collected in the economy

I = *Infaq* (aggregate private spending for the sake of Allah)

z = average and marginal rates of *Zakat*

r = average and marginal propensity to save for the sake of Allah

Therefore, according to Ahmad, consumption of *Zakat* and *Infaq* payers (C_1) depends upon his income net of the *Zakat* and *Infaq* expenditures. The constant 'b' is assumed to be less than 1 but greater than 0. Its value is postulated to depend upon how far Islamic injunctions are operative in the society. In case, injunctions for moderation in consumption are institutionalised, it is assumed that the

[3] See Chapter 3 section 2(b) for explanation of this concept.

value of 'b' would be lower than what one would get in the conventional capitalist society.

(ii) Consumption function for the *Zakat* and *Infaq* recipients

This is represented by: $C_2 = Z + I$

That is, consumption expenditure of *Zakat* and *Infaq* recipients depends upon the amounts of *Zakat* and *Infaq*. It is implicitly assumed here that this second category of consumers does not have any other source of income. This would also imply that the marginal propensity to consume would be equal to unity.

(iii) Aggregate consumption function for the whole economy

The aggregate function would now be the sum total of the above two functions. That is:

$$C = C_1 + C_2$$

or, $$C = a + b\,(Y - Z - I) + (zY + rY)$$

or, $$C = a + bY - bZ - bI + zY + rY$$

or, $$C = a + (b + z + r)Y - b(Z + I)$$

Thus aggregate consumption expenditure of all groups in the society (C) depends upon the consumption expenditure of *Zakat* and *Infaq* payers (C_1) and consumption expenditure of *Zakat* and *Infaq* recipients (C_2).

This model gives three types of propensities: marginal propensity to consume ('b'), marginal rate of *Zakat* and *Infaq* (z) and marginal propensity to save for the sake of Allah (r). All these propensities are postulated to be positive and less than unity, i.e., $0 < b < 1$, $0 < z < 1$ and $0 < r < 1$. It is also argued that b, z, and r will have value equal to unity if all income is spent on any one of them and zero if nothing is spent. Since this is highly unlikely in the practical world, the expected values of the coefficients would be greater than 0 but less than 1.

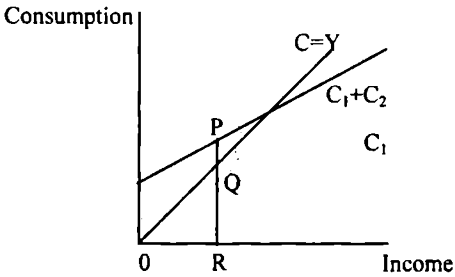

Figure 4: Consumption Function of an Islamic Economy

Slopes of different functions of this model are also note-worthy. For the consumption function of the *Zakat* and *Infaq* payers (C_1), the slope is b whose value is assumed to be $0 < b < 1$. The slope the total aggregate function is $(b + z + r)$, in the last equation above, which is higher than that of C_1 function.

Ahmad has depicted his model in terms of a diagram (Figure 4). In this figure, consumption and income are measured in the vertical axis and horizontal axis, respectively. $C = Y$ line is the usual 45^0 degree line. The curve C_1 shows the consumption function for the *Zakat* and *Infaq* payers. Its slope is equal to b. When the net disposable income is OR, consumption expenditure is QR. The aggregate consumption function is depicted by the line $C_1 + C_2$. Its slope is $(b + z + r)$ which is higher than b, since all the three coefficients b, z and r are positive and less than 1. When the income is OR, consumption expenditure is PR. Interestingly, the consumption expenditure of the *Zakat* and *Infaq* recipient's (C_2), is the difference between PR and QR i.e., PQ. Diagrammatically, the amount of consumption expenditure of this group depends upon the gap between the slopes of C (aggregate function) and C_1. The reader can see that the gap between the two lines increases as income level increases.

This simply implies that as income level increases, expenditure on *Zakat* and *Infaq* increases.

These are, in short, the basic features of Ahmad's model of aggregate consumption suitable for an Islamic economic society. The main advantage of this model is that it is very simple and straightforward. The author has very successfully incorporated the Islamic concepts of *Zakat* and *Infaq* in to the consumption function. The inadequacies of this model are that it deals only with linear approximation and has avoided the more practical but somewhat complicated non-linear functions.

REFERENCES FOR FURTHER READING[4]

1. M. A. Mannan (1984), 2. Ausaf Ahmad (1992).

[4] Detailed references are given at the end of the Book.

Chapter 9

SAVING AND INVESTMENT BEHAVIOUR IN ISLAM

[**Key concepts:** loanable funds – saving-investment decisions – PLS banking system – *Mudaraba* – *Musharaka* – savings-investment levels – capital income uncertainty – non-capital income uncertainty – precautionary demand for money – stability of financial system]

The basic purpose of this chapter is to analyse the saving and investment behaviour from an Islamic perspective. Before we go on to do this it would be necessary to say a few words about the same in the conventional economic system.

1. SAVING AND INVESTMENT BEHAVIOUR IN THE CONVENTIONAL ECONOMY

From the viewpoint of socio-economic development, the study of the behaviour of saving and investment is very crucial. The basic question is: how are the decisions of saving and investment taken? Truly speaking, these decisions are taken by two distinct groups of individuals, the savers and the ultimate investors. It is the banking system, which actually acts as the mediator. That is it helps the savers and actual investors to 'meet' together, although they never 'see' each other directly. The weapon that helps all these happen is the **interest.** The savers keep their money in the bank for safe custody and for assured source of income (fixed rate of interest). The bank lends this money to the investors against collateral and gets an assured source of income (through fixed rate of interest). Incidentally, the latter rate is always higher than the former, and the difference between these two rates is the income of the bank.

In the standard economic theory, these are demonstrated as under:

$$S = f(i)$$
$$I = f(i)$$

where,

S = supply of saving
I =demand for investment
i = interest

Saving (S) is positively related to the rate of interest (i). In other words, the higher the rate of interest, the more is the supply of loanable funds (or supply of savings). On the other hand, the relationship between investment (I) and the rate of interest (i) is negative. That is, the higher the rate of interest, the lower is the demand for loanable funds (or investment demand). The rate of interest is determined at the point where saving and interest becomes equal. Diagrammatically, this can be illustrated as follows.

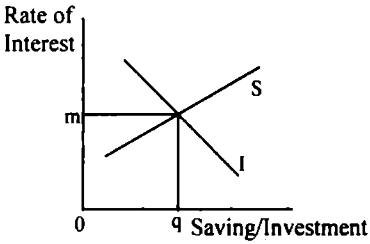

Figure 1: Saving- Investment Equilibrium in the Conventional Economy

In the diagram S and I intersect at point P. This is the equilibrium point at which the rate of interest is indicated by m and the quantity of S (=I) is indicated by q.

2. SAVINGS AND INVESTMENT BEHAVIOUR IN AN ISLAMIC ECONOMY

The very foundation of the financial system of the conventional economy, namely interest, is replaced by profit-and-loss sharing (PLS) system in an Islamic economy. This gives rise to a number of issues:

(a) How saving and investment decisions are made in the absence of interest?
(b) Are saving and investment adversely affected under the PLS system?
(c) Is the new system less stable when compared with the existing interest-based system?

We now turn our attention to discuss each of these issues in turn.

(a) Saving and Investment Decisions

Under the Islamic system, savers keep their money not for getting a fixed rate of return (i.e., interest) but for having the share of profit or loss. On the other hand, the bank (the same mediator as in the conventional financial system) also does not receive fixed return but share profit-and-loss with investors. Here money is not directly exchanged for money, but money is first exchanged for goods and service (buying) and then these goods and services are exchanged for money (selling). Fixed rate of return is not possible here. The role played by the bank as the mediator remains unchanged. The question we are asked: How under an Islamic system savings and investment decisions are made? We discuss this issue below.

The first attempt to address this issue was made by Siddiqi (1983).[1] He developed a model of full-fledged PLS banking system. The analysis was based on the assumption that there is an expected profit rate in the economy, almost like interest rate, which guides the savings and investment decisions. He shows that, instead of interest rate, savings and investment now depends upon the profit sharing ratio. If K denotes the share of profit that goes to the savers, then, it is shown, the demand for funds is a decreasing function of K, while the supply of funds is an increasing function of K. In other words, the lower the proportion of share going to the savers, the higher is the savings and just opposite happens in the case of higher proportion of profit going to the savers. The picture is just the opposite in the case

[1] The descriptions of the following two contributions are based on Waqar M. Khan (1992).

of supply of funds. This implies that the market clearing is on the basis of an equilibrium K that equates the quantity demanded of funds with quantity supplied. The standard comparative static results are obtained from this procedure.

This model provides an excellent insight about the saving-investment decisions. Siddiqi's basic contention is that this profit sharing ratio will guide the allocation decision under the Islamic financial system. It should be remembered that this type of voluntary negotiation of the profit sharing is very much allowed in Islam when done through arrangements as *Musharaka* and *Mudaraba.* It is also interesting to point out that under this model the new pricing mechanism is a sort of inverted solution of the fixed interest rate pricing. This can be ascertained from the following relation:

$$r = \frac{KP}{I} = \frac{P}{I} K = cK$$

Where,

r = rate of return for the party
K = share of profit that goes to the savers
P = amount of profit
I = level of investment
c = P/I = assumed constant

From the above equation, it becomes clear that if level of investment (I) and the amount of profit (P) are given, the relationship between r and K becomes direct. Instead of targeting r, Islam allows targeting K. Thus the solution is in direct contrast with the fixed return system in terms of interest.

Siddiqi's model, however, assumes that the mere substitution of the interest rate by the profit sharing ratio will leave the saving-investment functions unchanged. This becomes clear, according to Khan (1991, p. 279), from the realisation that interest rate and profit sharing ratio enter in to the maximisation problems of savers and investors in an entirely different manner. That is: 'Interest enters as a charge on income whereas sharing implies a participation in the residual income' (bid, p. 279). This has been treated as an inadequacy of the Siddiqi's model.

Haq and Mirakhor (1987) have tackled this inadequacy. They explicitly analyse the maximisation problems of the savers and investors and obtain the relevant saving-investment functions in a PLS system. Their model gives that saving function is increasing in the profit ratio for savers whereas, interestingly, the investment function is independent of this ratio. In this case the choice variable for the investors is the level of investment. Given the technological constraint, he chooses to maximise his share of profits. In their model, the sharing parameter appears multiplicatively in the maximisation problem, which, for obvious reason, drops out in arriving at the marginal condition. The marginal condition is attained at the point where the marginal product of investment becomes equal to the price of investment. In the traditional analysis this is equated with 1 + r, where r is the rate interest. However, in the Haq-Mirakhor model, this is equated with simply 1, that is, there is no interest rate factor. This happens simply because of the fact that in this case there is no fixed price of investment funds. In effect, this is the most interesting result arrived at by the authors. This shows that technology is the only constraint faced by the investors under the PLS system.

Therefore, according to the Haq-Mirakhor model, the level of investment is determined not by the cost of funds but by the technological feasibility of investment. Hence, the investment demand function is independent of the profit sharing ratio.

Regarding the decision problem of the savers, it is known through the model that the profit sharing ratio appears in the maximisation problem almost in the same way as the interest rate in the conventional saving-investment theory. In other words, the higher the rate of profit-sharing ratio, the higher will be the level of saving (just like interest-saving relationship). This implies that there will be a higher return on saving for a given level of profit.

It may be added that, according to the Haq-Mirakhor model, the level of investment/saving is supply determined. The only factor, which can alter the level of investment, is the technological possibilities. It may also be interesting to point out that the changes in saving habits may have influence on the rate of return but this will have no impact on the level of investment.

(b) Saving and Investment Levels

This section will examine the issue whether savings and investment are adversely affected in the PLS financial system. We begin with the case of savings.

Much of the scepticism about the new system is directed towards saving. It is apprehended that savings will be adversely affected under the PLS system. The argument put forward appears to be straightforward. Under the interest-based system, the savers get a pre-declared fixed rate of return. This is not the case under the Islamic system. Here the bank can not declare with any degree of certainty the rate of profit that it would be able to give to the depositors. Note again, this depends on the level of profit actually earned after the expiry of the project period.

Counter arguments are now in abundance in the Islamic economics literature to demonstrate that the above analysis is not true. In his article Waqar M. Khan (1991, p. 281) has shown that in order to analyse the issue in hand it is necessary to make a distinction between two different types of uncertainty usually faced by the savers. These are 'capital income uncertainty' and 'non-capital income uncertainty'. The capital income uncertainty relates to the uncertainty that is an outcome of the investment decisions made against the present income. The level of uncertainty in this case is endogenous as it depends on the level of savings that is a choice variable in the model. On the other hand, the non-capital income uncertainty relates to the uncertainty regarding the level of future income stream of the saver and is independent of the decisions taken by them. This type of uncertainty and its extent is largely exogenous to the model.

It has been established beyond doubt that savings under non-capital income uncertainty will not be adversely affected. It will increase with degree of uncertainty. Its explanation is simple. Saving under this scenario is regarded as **precautionary** in nature. If we assume that a rational Islamic economic man will strive to smooth out his consumption over his life cycle, an increase in uncertainty would require a greater cushion for the future from present resources, that means that the level of saving will increase.

However, this is not the type of saving that is relevant for the consideration of a PLS system. Savings that are made to augment the future level of income are the ones relevant for this system. In this case, the earnings are a function of a random rate of return. The question is how does saving react to an increase in uncertainty regarding the return on saving? The study made by Haq and Mirakhore as mentioned in Masood Khan (1992, p. 281) shows how saving will respond to a PLS system. For this, one is required to see what type of return-uncertainty configuration is offered by the new system.

The analysis shows that the new system will offer higher rate of return without exposing savers to correspondingly higher levels of uncertainty. The reasons are, first, since on average profits is positive they cover the average borrowing costs. This means that the PLS system can offer better rates of return to depositors than those offered by the traditional system. As for the investors, the reduction in profit rates will be compensated by reduced risk they will face under the new system. Second, under the PLS system, banks can finance much riskier projects than_those allowed by the interest-based system. This implies that in the new system the overall rate of profit will be higher. This in turn implies that the bank would be in a position to offer higher rate of return to its depositors. One additional advantage that can be claimed in the new system is that intermediation through banks will ensure that, with adequate diversification, small savers will be protected from individual project failures.

(c) Stability

This section examines the stability of the Islamic financial system vis-à-vis the conventional system. For the purpose of this analysis the word 'stability' is defined as the 'capability to absorb unanticipated shocks'. Therefore, a stable financial system would imply that the financial system could absorb shocks without disrupting its smooth functioning. In the paragraphs to follow it is shown that the Islamic PLS- based financial system is more stable than the traditional interest-based system. The arguments are based on Cone as referred to in the article as mentioned here.

(i) The traditional financial system is less stable

The instability in the traditional interest-based financial system emanates from the divergence in its value of liabilities from the value of its assets. In this system, the bank issues fixed liabilities to depositors by guaranteeing the nominal value of their deposits along with a fixed return in terms of interest. On the other hand, the advances made by the bank typically carry a risk of default. That is, the money loaned out, along with the declared rate of interest, may not come back, for genuine or artificial reasons. Of course, the bank keeps some money as emergency funds in order to meet such unpaid loans. Such reserves are generally insufficient to absorb major shocks in the financial system. In case the reserves and the value of all assets are not sufficient to meet the fixed liabilities of the depositors, this eventually lead to bankruptcy, an event that is generally called 'a run on the bank'.

This is the obvious outcome of the event described above. What happens is that each depositor has a fixed claim of the bank. When he hears the precarious situation of his bank he thinks that, by this time, other depositors must have gone to the bank and have withdrawn their money. So, without sparing any time, he also rushes to the bank to get his money. Since every depositor is doing the same thing, i.e. too many people chasing too little money, the banks completely fails to comply with: there is a run on the bank which none can prevent under normal circumstances.

(ii) The Islamic financial system is more stable

In the Islamic financial system the above-mentioned critical situation is highly unlikely to occur. First, in this system, there is remarkably equality between liabilities and assets of the bank, here the Islamic bank. Truly speaking in the system, the two sides (the bank and the depositors) are transparent. Like the traditional system, the assets here are no more risky than what is allowed by the kind of liabilities the bank has issued. Second, if any emergency situation arises there is less likely to be a run on the bank. The reason is very simple. The depositors do not rush to the bank. Because they know it very well that whatever may be the financial position of the bank, they

have their **due shares guaranteed.** Under this circumstance, what is likely is that the depositors will wait and see what ultimately happens. The conscious depositors would rather remain in the bank as depositors in the hope that the bank would take the necessary steps to save the bank and soon be in a position get rid of the hurdle it is facing at the moment. They would do this simply because if they get their deposit back they would have to accept losses.

(d) Concluding Remarks

The chapter has discussed the saving-investment behaviour in an Islamic financial set up. It is shown that the PLS system can quite satisfactorily answer the questions raised at the beginning regarding the saving-investment decisions, levels of saving and overall stability of the economy. In effect, the new system is found to be more efficient when compared with the interest-based system. Waqar M. Khan in the stated paper adds:

> 'Recent developments in the international financial markets indicate that there is growing awareness of the inherent problems associated with the debt-based system. The most notable development is the manner in which the world debt problem is being handled. Increasingly, the creditors are realising that recovery of loans on original terms and conditions is quite impossible. The only viable solution to the world debt problem is either a write-off or a conversion into some kind of equity based instruments. Both these methods are adopted to ease this problem. The latter is gaining increasing popularity and now a well established market deals in debt-equity conversions' (Ibid. p. 283).

REFERENCE FOR FURTHER READING[2]

1. Waqar M. Khan (1991)

[2] For details, see the list of references given at the end of the Book.

Part - IV

MONEY AND BANKING

'THOSE WHO DEVOUR USURY WILL NOT STAND EXCEPT AS ONE WHOM THE EVIL ONE BY HIS TOUCH HATH DRIVEN TO MADNESS. THAT IS BECAUSE THEY SAY: 'TRADE IS LIKE USURY,' BUT ALLAH HATH PERMITTED TRADE AND FORBIDDEN USURY' [BAQARA 2:275].

Chapter 10

MONEY

[**Key concepts:** Barter system – Near money, narrow money and broad money - deficit financing – credit creation – primary and derivative deposits – statutory reserve ratio – credit ceiling – value-oriented allocation of credit – variable government deposits – foreign exchange swap – PLS certificates – moral suasion]

1. MONEY IN AN ISLAMIC ECONOMY

(a) Barter versus the Use of Money and Islam

Man since time immemorial has known barter system. The system involves the exchange of goods against goods. It is not surprising that in ancient days people exchanged food for weapons. Although the system represents a great improvement over a state of affairs in which every man had to be a jack-of-all-trades and master of none, it was gradually discovered that it has to operate under grave disadvantages. An adequate division of labour is almost unthinkable in the barter system. It is not always easy to replace a single transaction by two transactions. Thus, If you have rice and want clothes, you shall have to find a person(s) who want to exchange clothes for rice, just opposite to what you want. Truly speaking, it took quite a few centuries to discover the use of money as a medium of exchange and as a measure of value.

Money simplifies economic life. But the barter system was still in prevalence (as it is still now in many societies). Although, strictly speaking, this system is not condemned in Islam, there are practices, which can lead to injustice and exploitation. Having recognised it, the Prophet allowed the practice only in limited cases and encouraged the use of money as a medium of exchange instead. For example, barter could take place in products of different varieties

provided the possession was passed on simultaneously by both the parties. Two goods of the same kind could not be exchanged except in those cases where the quantity was equal and the possession was transferred simultaneously. History shows that the Prophet issued instructions in several cases not to enter into barter agreements. Just to quote one *Hadith*:

> Abu Huraira and Abu Said al-Khudri reported that Allah's Messenger deputed a person from Banu Adi al-Ansari to collect revenue from Khaibar. He came with a fine quality of dates whereupon Allah's Messenger asked: 'Are dates of Khaibar like this?' He replied: 'Allah's Messenger, it is not so. We buy one *sa* of (fine dates) with two *sa* of the dates of different qualities mixed together'. Whereupon Allah's Messenger said: 'Don't do that, but like for like, or sell this (the inferior quality) and receive the price and then buy with the price of that, and that would make up the measure.'

The role of money as a store of value was also recognised by the Prophet when he levied *Zakat* on monetary assets as well. This also suggests that money have been treated as a factor of production as well: It has the potentiality to grow and create more value.

As compared to capitalism, Islam treats money as a medium of exchange and a store of value but not as a commodity, since money by itself can not perform any function. It becomes useful only when it is exchanged into a real asset or when it is used to buy a service. Therefore, it can not be bought or sold on credit.

(b) Kinds of Money

There are three kinds of money: coins, paper currency and bank deposits. There is another category of money called near money (e.g., government bonds). In the economic literature, the following notations are used to denote various kinds of money:

$$M = M_1 + M_2$$

Where,

M = Total money supply

M_1 = coin + paper currency + demand deposits of all banks

$M_2 = M_1 +$ time and savings deposits of the bank
M_1 is called **narrow money** and M_2 is called **broad money.**

(c) Sources of Monetary Expansion

There are two sources of monetary expansion:

(i) Deficit financing, and

(ii) Credit creation.

In order to ensure the desirable monetary growth, it would be of utmost importance to monitor these sources. These are discussed below.

(i) Deficit financing

In an undeveloped country, this is basically the result of fiscal deficit. Although most of the developing Muslim countries can produce some surplus in its revenue budget but that surplus is too inadequate to meet the development expenditures. Bangladesh, for instance, can not finance even half of its development expenditures from its internal sources.

Need for deficit financing, which basically means borrowing from the central bank, arises because of at least three main reasons. First, the inability or unwillingness of the governments to raise adequate finance through taxation and other non-inflationary sources to meet their essential and productive needs. Secondly, lack of unwillingness on the part of the governments to eliminate or reduce substantially the unproductive and wasteful expenditures. Thirdly, non-availability of sufficient amount of foreign aid with acceptable terms and conditions is another factor. Excessive expansion of monetary supply cannot be overcome unless and until these factors are properly dealt with.

The undeveloped Muslim countries have little control over the third cause i.e., the availability of adequate amount of foreign aid. Therefore, what is needed for these countries is to concentrate on the issues related to domestic affairs. An Islamic government will make its all out effort to remove the obstacles standing on the way of mobilising the required amount of domestic resources. It is known that

in certain sectors of the economy the people are overtaxed whilst in the other sectors the people are under-taxed. The latter happens not because of any socio-economic considerations but because of the desire to please the vested interests: they provide the political expenses. Rather than resorting to deficit financing, it would be advisable on the part of the developing Muslim countries to try to rationalise the tax structure and streamline the tax administration so that more resources could be obtained from the domestic sources.

The need to reduce, if not to eliminate, unproductive or wasteful expenditures, can not be overemphasised. As the government of a Muslim country should act as a trustee of the resources given by Allah, it is the responsibility to reduce unproductive expenditures. Unless and until this is done it will not be possible to attain goals of Islamic economic development.

According to Chapra (1985, p. 192), the balance of government spending can be divided into three parts: (1) normal recurring expenditures, (2) project expenditures, and (3) emergency expenditures.

According to Chapra, all recurring government expenditures must be financed by tax revenues. No other source (say foreign aid) should be used for this. All project expenditures should be financed through selling shares to financial institutions and the public. A commercially-oriented pricing system should be adopted without a general subsidy. All subsidies needed for the poor and needy should be financed from *Zakat* revenues or from *Qard Hasan* funds. All emergency expenses like war should be financed by compulsory borrowing. War means sacrifice. So rich people should be motivated to bear the burden of the war expenditure.

(ii) Credit creation

Deposits of the commercial banks constitute a very important source of monetary expansion. Two types of deposits are normally distinguished: **primary deposits** and **derivative deposits.** The former provides the banking system with the base money which includes

cash-in-vault and deposits with the central bank. The latter represents the money created by the banking system in the process of credit expansion and constitutes a major source of money expansion. This derivative deposit leads to an increase in the money supply in the same manner as the increase in the supply of currency paper notes by the monetary authority and hence it has the potential of being inflationary in the absence of an offsetting growth in output. It is, therefore, necessary to regulate this supply of derivative deposit. This can be accomplished by regulating the availability of base money to commercial banks.

The question remains: do Islamic banks through their operations create credit? More specifically, is **multiple deposit creation** possible under Islamic banking as it is under traditional banking? Islamic economists differ in their opinions regarding this. Some argue that traditional banking is based on the concept of lending and the Islamic banking is based on the concept of partnership say, *Mudaraba* system. Each *Mudaraba* advance is restricted to a corresponding increase in the productive capacity. Hence there is no scope of excessive credit creation leading to economic instability. Although, this argument can not be denied, it should not be forgotten that it is not a single bank, traditional or Islamic, that creates credit. The classical view goes: 'what an individual bank can not do, the banking system as a whole can do'. According to Ausaf Ahmad, the ability or power of the Islamic banking system to create multiple deposit would depend upon the following two facts (1997, p. 2):

(i) That a loan advanced by a bank never leaves the banking system. It comes back to another bank in the form of a deposit, which can be used for making another loan.

(ii) Fractional reserve system allows a bank to resort to multiple deposit creation.

If Islamic banking is solely based on *Mudaraba*, there can still be excessive creation of credit. Because in this case it is only changing the terms of the contract on which an advance is provided to the clients. It does not alter the fact of multiple advances, which is possible under the fractional reserve system.

2. ISLAMIC MONETARY POLICY

Monetary policy is an important instrument used for the fine-tuning of a modern economy. Roughly, it refers to regulation, supervision and management of money market. This section will first specify the basic objectives of monetary policy and then identify the instruments through which the proposed objectives can be achieved.

(a) Objectives of Monetary Policy

In the modern economy, the objectives of monetary policy are well specified. The question is: are these objectives acceptable for an Islamic economy? Most of the Islamic economists are of the opinion that the objectives of monetary policy need not necessarily be different from those of the modern economy (although the mechanisms through which these are to be achieved may or may not be the same). The following can be regarded as the objectives of monetary policy of an Islamic economy.

(i) To promote a sustained and balanced economic growth in the country and to mobilise resources for economic development;

(ii) To maintain stability in the value of money so as to avoid excessive periodic fluctuations;

(iii) To maintain stability in the external value of the currency; and

(iv) To promote an equitable distribution of income and wealth.[1]

(b) Instruments of Islamic Monetary Policy

Monetary policy is implemented by the central bank. A number of instruments are employed to achieve the objectives as specified above. In the modern economy, several instruments are used. These are generally divided into three groups:

(i) **Traditional Quantitative measures:** Legal Reserve Ratio, Bank Rate Policy, Open Market Operations and Credit Rationing; and

[1] See Ausaf Ahmad 1997, p. 3.

(ii) **Traditional Qualitative measures:** Selective Credit Controls, Moral Suasion and Issue of Directives.

(iii) **Pure Islamic measures:** Profit Sharing Ratio, Target Growth in M_1 and M_2, Public Share of Demand Deposits, Value-Oriented Allocations of Credit, Variable Government Deposits, Foreign Exchange Swap, Common Pool and Purchase and Sale of Stocks of PLS Certificates.

In Islamic economics, all these measures may or may not be suitable. Consequently, we shall first discuss these traditional instruments and make some observations on their suitability. Next an attempt will be made to suggest some additional instruments strictly from the viewpoint of Islam. For ease of exposition, the instruments are discussed under three heads: traditional quantitative measures, traditional qualitative measures and pure Islamic measures.

(i) Traditional quantitative measures

Legal Reserve Ratio: This is a standard method of credit control.. The central bank requires the commercial banks to reserve a certain part of their deposits. The ratio of these compulsory reserves is called Legal Reserve Ratio (LRR) or Statutory Reserve Ratio. By imposing the LRR, the central bank can limit the growth of the bank deposits. Normally a commercial bank is required to keep 10-20 per cent of their demand deposits with the central bank as statutory reserves. Incidentally, the inverse of reserve ratio is known as 'money multiplier'. By changing the statutory reserve ratio, the central bank aspires to change the value of money multiplier as well as the monetary base that is used to create credit.

In the conventional economic framework, this LRR is used as one of powerful weapons of the monetary policy. In the Islamic monetary policy this LRR can also be used to control the deposit of the Islamic commercial banks. The LRR could be varied by the central bank in accordance with dictates of the monetary policy.

The funds received by the central bank through LRR may be used by it for two purposes. First, a part of the reserve may be kept in a general pool created for helping the Islamic commercial banks at the

time of crisis. In other words, with this fund thus created, the central bank can really act as the lender of the last resort within the agreed limits and constraints. Second, the other part can be invested in profit-and-loss bearing securities, and not on interest-bearing securities.

In Bangladesh the Islamic banks are required to maintain 10 per cent of their demand and time liabilities with the Bangladesh Bank (the ratio is 20 per cent for the traditional banks). The Bangladesh Bank has the power to impose fines in case of non-fulfilment of this requirement.

Bank Rate Policy: This refers to interest rate which the central bank charges on its advances to commercial banks. Through this technique, the central bank can control the lending rate of the commercial banks. In the Islamic society this method is not applicable since it involves 'interest'. However, if the bank rate can be replaced by the Islamically permitted technique, this policy can be applied in the Islamic economy too. One such technique is the profit-sharing ratio.

Open Market Operations (OMOs): These are powerful tools for the implementation of monetary policy in the conventional economies, particularly in the advanced countries. This denotes sale and purchase of government securities, treasury bills and short-term bonds. For an Islamic economy, this method is not applicable at least for two basic reasons. First, almost all-financial instruments used in these operations are based on interest. Second, the financial markets of most of the Muslim countries are underdeveloped.

However, attempts are being made to make the OMOs operational even in the Islamic countries. One suggestion is that the central bank of the country would buy and sell the shares of commercial banks. When the central bank would like expansion of the money supply, it would purchase the commercial shares held by individuals, business companies and commercial banks. For the contraction of money supply, the central bank would sell the shares

held by it. However, too much interference by the central bank in the money market may hamper the smooth functioning of the market. Another suggestion is to evolve some Islamic financial instruments in which yield of the bond is related to the yield of some productive projects. It is possible to float *Mudaraba* bonds, *Musharaka* bonds, *Ijara* bonds, and the like. These instruments would be free from *Riba.* In any case, OMOs, if they are to be used in the Islamic economy, would have to be modified to suit the tenets of Islam.

Credit Ceiling: Under the conventional economic system, credit rationing is not at all an unpopular method of credit control. This is an indirect method and is free from interest. Hence, this can very well be employed as a method of credit control in the Islamic economy. In this method, each commercial bank is assigned a credit ceiling by the central bank. This is in a sense putting a limit on the credit creation of the commercial banks. If a bank exceeds its credit ceiling, it has to deposit with the central bank an amount equal to the excess. If this is violated, some penalty in the form permitted by the *Shariah* may be imposed.

(ii) **Traditional qualitative measures**

Selective Credit Control: This measure actually aims at changing the direction of credit. Islamic economists consider this method as very important for Islamic economies, particularly the poor ones. For the poor countries matching finance is an important indirect method. In this the central bank provides matching credit facilities to those commercial banks, which extend credit to priority areas or sectors identified by the central bank. The bank may provide credit either on *Qard Hasan* or on a lower profit sharing ratio. In Bangladesh, financing small and cottage industries or more allocation to the agricultural sector is an example in point.

Moral Suasion: Moral suasion refers to informal contacts, consultations and meetings between the central bank and the commercial banks. This is a tested instrument of monetary policy of

the traditional monetary system and can also be employed in the Islamic economy. In this case, the central bank through its personal contacts, consultations and meetings with banks could keep itself abreast of the strengths and problems of banks and suggest to them measures to overcome their difficulties. If found suitable, the central bank may suggest the commercial banks to maintain a reasonable range of profit-ratios between depositors, banks and entrepreneurs The Pakistan Council of Islamic Ideology is effectively using this technique in the banking system. This mechanism is expected to become more effective when it becomes necessary to ensure equity or eschew unhealthy competition. There are Islamic economists who believe that this method should play a more significant role in an Islamic economy when compared with the traditional economy.

Issue of Directives: The central bank can issue directives to all or any particular commercial bank. In the traditional banking system, this is accomplished by regulating interest rates. In an Islamic economy, the central bank can do the same thing by regulating profit sharing ratios on various kinds of savings and investment deposits. The central bank can also influence the flow of finances to specific sectors by changing maximum permissible profit sharing ratio for specific sectors in case of *Mudaraba* contracts and by changing the range for mark up in the case of *Murabaha* contracts.

(iii) Pure Islamic measures

Besides the traditional methods of credit control as discussed above, the Islamic economists have suggested a number measures that can be applied to achieve the objectives of monetary policy of the Muslim countries. Some of these are briefly described below.

Profit Sharing Ratio: This is a new instrument of monetary policy suggested by Islamic economists. This ratio may perform the same function as the interest rate performs in the conventional economy. It has the same power to regulate money supply. The profit sharing ratio between the depositors and the commercial banks, called

depositor's sharing ratio, and that between the banks and the entrepreneurs, called borrower's profit sharing ratio, can be used to regulate the supply of money and the demand for money, respectively. The central bank can give guidelines about the maximum and minimum profit sharing ratios for different purposes and for different sectors. By manipulating these ratios, the central bank can influence the direction of the flow of financial resources and thus achieve the objectives of its monetary policy.

Target Growth in M and M_2: This method has been suggested by Chapra (1985). According to him, the central bank can determine annually the desirable growth in money supply (M) in the light of national socio-economic goals. This target level of money supply is reviewed quarterly, or as often as necessary. The targets are not, however, to be changed frequently but only when circumstances warrant it.

As a component of total money supply, M_2, which is often called **high-powered money,** is also to be regulated by the central bank. This would, of course, require an appropriate goal-oriented fiscal policy and proper regulation of the access of the commercial banks to the central bank credit.

According to Chapra (1985, chapter 7), since the creation of M_2 results from the exercise by the central bank of the power to create money, which is purely social prerogative, the resources derived from this power should be used only for goals of the Islamic society. That is, they should be used particularly for financing projects that would help realise the Islamic ideals of the Muslim *Ummah.*

For realising this goal, the central bank should make the total M_2 created by it available partly to the government and partly to the commercial and specialised financial institutions. The part made available to the government should be obviously an interest-free loan to enable the government to finance its social welfare projects, including the provision of housing, medical facilities and education to the poor. The part made available to the commercial banks should be

in the form of *Mudaraba* advances, and not on discounting of bills. The central bank should be able to use this money as a major quantitative as well as qualitative instrument of credit control. The amount given to the commercial banks should be adequate to finance the desired growth of economic activity in the private sector without causing any inflationary pressure. The profit thus realised by the central bank should be used to finance projects that are primarily related to the alleviation of poverty. A part of this would of course be retained by the central bank for meeting its expenses. Lastly, the part made available to the specialised financial institutions should also be on *Mudaraba* system. It should be used for financing the productive activity of the self-employed persons, farmers, rural industries and small businesses. All these would help reduce the rural-urban gap as found in many Muslim countries.

Public Share of Demand Deposits: According to Chapra, a certain proportion of commercial bank deposits, up to a maximum of, say, 25 per cent, should be diverted to the government to enable it to finance welfare-oriented projects in which PLS is not feasible or desirable. This should be in addition to the amount diverted to the government by the central bank for expanding the monetary base. There are three main reasons for this: Firstly, the commercial banks act as agents for mobilising the idle resources of the public; secondly, the banks do not pay any return on demand deposits; and thirdly, the public does not bear any risk on these deposits if these are fully insured. These are actually the rationale for suggestion that part of the deposits created by the commercial banks should be diverted by the commercial banks and that it should be used for the benefit of the poor.

Value-Oriented Allocation of Credit: This is a very important instrument of Islamic monetary policy. Bank credit comes out of the funds that belong to the public. Therefore, it is quite natural to expect that these funds should be so allocated that it helps realise

the general social welfare. According Chapra, there are two criteria: realisation of the goals of the Islamic society and maximisation of public profit. This can be achieved only when credits are so allocated that it helps 'optimum production and distribution of goods and services needed by the majority of the society', and the 'benefits go to an optimum number of businesses in the society.'

The appropriate way to achieve these objectives will be to prepare a **'value-oriented plan'** for the commercial banks. The problem with the conventional banking system is that they do not use their funds in an area where risk is great and profit (if there is any) is comparatively small. This is the reason, which explains small allocation of funds of the commercial banks to the small and medium-sized businesses. It should be understood that the small and medium-sized businesses constitute the bulk of the economic activities in most of the Muslim countries. They must be financed. The Islamic monetary policy makes provisions for these businesses. Introducing a loan guarantee scheme underwritten partly by the government and partly by the commercial banks may reduce the risk that is involved. Although under the Islamic system the guarantee scheme cannot guarantee the repayment of loan with interest, it can relieve the bank of the need to ask for collateral from the small businesses whose general credentials have been registered with or certified by the guarantee scheme. The scheme would do this after proper investigation of the firms concerned. It will arrange the training of the businesses to maintain proper accounts and be prepared to get the accounts audited when needed. The bank will receive its money back in case of moral failure of the business. In the case of the market failure and the resultant loss, the bank will share the consequences with the proportion to the financing provided by it.

Chapra also maintains that the additional expense incurred by the Islamic banks in evaluating and financing small businesses should be partly or wholly offset by the government depending on the nature of the case and the objectives to be served. This cost should be borne by the Islamic governments in the greater interest of the society. It can realise the costs partly or wholly from the fees to be collected out of

the profits earned from such financing by the banks and the small businesses.

Variable Government Deposits: Variation of the government demand deposits with the commercial banks can be regarded as another important instrument of Islamic monetary policy. Chapra has noted that 'Shifting of a part of government deposits by the central bank to and from the commercial banks for achieving monetary policy objectives has proved to be a useful instrument of monetary policy in Saudi Arabia and has performed the same function directly that open market operations perform indirectly in influencing the commercial bank reserves.'(Chapra 1985, foot note 16, p. 213).

Foreign Exchange Swap: In countries where there is foreign exchange control, this technique can be employed. In this case, the central bank agrees to swap local currency for foreign exchange when the commercial banks fell a squeeze, with the undertaking that the banks will repurchase the foreign exchange from the central bank after a specified period at the exchange rates, subject to a spread. The spread between the purchase and repurchase rates may be varied by the central bank to penalise, or to relieve the commercial banks, as desired. Chapra warns that this facility should not be available to banks for indulging in foreign exchange speculation.

Common Pool: This is another instrument that can be effectively used for monetary policy purposes by the central bank. This would be in the nature of a co-operative arrangement between banks under the patronage of the central bank to provide relief to banks in the case of liquidity problems.

Purchase and Sale of Stocks of PLS Certificates: The purchase and sale of stocks of profit-and-loss-sharing certificates will be an alternative mechanism to purchase and sale of government securities in the open market operations. It is not desirable to buy and sell stocks of private companies, the stocks should be of the public sector companies only.

(iv) Summary

The basic instruments of monetary policy in an Islamic economy, when compared with the traditional instruments, can be shown as follows.

TYPE OF INSTRUMENTS: WHETHER SUITABLE IN ISLAM

Traditional Quantitative Instruments	
1. Legal Reserve Ratio	: Suitable
2. Bank Rate Policy	: Unsuitable
3. Open Market Operations	: Need modifications
4. Credit Ceiling	: Suitable
Traditional Qualitative Instruments	
5. Selective Credit Control	: Suitable
6. Moral Suasion	: Suitable
7. Issue of Directives	: Suitable
Pure Islamic Instruments	
8. Profit Sharing Ratio	
9. Target Growth in M and M_2	
10. Public Share of Demand Deposits	
11. Value-Oriented Allocation of Credit	
12. Variable Government Deposits	
13. Foreign Exchange Swap	
14. Common Pool	
15. Purchase and Sale of Stocks of PLS Certificates	

REFERENCES FOR FURTHER READING[2]

1. M. Umar Chapra (1985); 2. Ausaf Ahmad (1997).

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[2] For details, see the list of references given at the end of the Book.

Chapter 11

ISLAMIC BANKING : THEORY

[**Key Concepts:** *Riba* - Islamic banking – *Bai Muajjal* - *Bai Murabaha* – *Bai Salam* *Musharaka* – *Mudaraba* – *Qard Hasan* – Hire purchase – *Ijara* Multi-form institution – *Al-Wadia* and *Mudaraba* accounts – Formal. informal and voluntary sectors – *Waqf* - empowering the whole family].

For an expanding economy, a developed and efficient banking system is indispensable. Among others, it helps transfer of financial resources from surplus units to deficit units. However, the modern banking system operates on the basis of 'interest', a predetermined rate of return on capital. In Islam, this interest (or *Riba*, to use the Quranic terminology) has been banned in an unequivocal language. Perhaps the single most contribution of Islamic economics is the creation and development of interest-free banking, often called Islamic banking, not only in the Muslim world but also in the non-Muslim world. Two chapters are devoted to the discussion of this banking system, one theoretical and one practical. We begin with the theoretical discussion.

1. INTRODUCING *RIBA*

The starting point on the theory of Islamic banking (and finance) is that Islam prohibits *Riba* and, therefore, it is essential that the readers understand the various aspects of *Riba* as clearly as possible. The following sub-section explains the conceptual issues relating to *Riba*.

(a) Prohibition of *Riba*

Riba is categorically condemned in Islam. According to the Quran, **'Those who devour usury will not stand except as stands**

one whom the Evil One by his touch hath driven to madness. That is because they say: 'Trade is like usury,' But Allah hath permitted trade and forbidden usury' [Baqara 2:275]. The Prophet also condemned, in the most unambiguous words not only those who take *Riba*, but also more who give *Riba* and those who record the transaction or act as witness to it. It is said, 'They are all alike (in guilt)'. **(Muslim, Trimidi).**

(b) Meaning of *Riba*

There are still some elements of confusion even among some of the Islamic scholars about the exact meaning of the term '*Riba*'. The Quran, perhaps because of the fact that the term was very popularly and extensively used during those days, has not given any clarification. Another reason may be that since the Quran is to provide guidance to humanity till eternity, the rationale for avoiding *Riba* may vary from period to period and in various socio-economic circumstances. However, English translators of the Quran (such as Abdullah Yusuf Ali and Mohammad M. Pickthall) have used the word 'usury' for *Riba*; for example, 'usurious rate of interest', implying that if the rate of interest is very high, it would then be called '*Riba*'. But how to ascertain whether a particular rate is 'very high' or 'very low'? For such business as transport or cinema, a rate of interest even exceeding 20 per cent may not be considered 'very high' but a rate of interest for such petty business as small grocery shop a rate even as low as 5 per cent may be considered to be high. It is because of this, Mannan in his path breaking book *Islamic Economics: Theory and Practice* says that the difference between *Riba* and interest is a matter of degree, and not of kind.

However, the word '*Riba*' literally means increase, addition or growth. But this does not mean that all types of increases or growths are prohibited in Islam. According to Umer Chapra, 'In the *Shariah, riba* technically refers to the 'premium' that must be paid by the borrower to the lender along with the principal as a condition for the loan or for an extension in its maturity' (Chapra 1992, pp. 56-57).

Given the definition 'Riba' and 'interest' would appear to be the same. In this book, therefore, interest and *Riba are* used interchangeably*.

(c) Basic features of *Riba*

The most important characteristic of *Riba* is that it is the positive and definite result of money when changed. In other words, when money begets money without being exchanged for goods or services, it is called *Riba*. Its distinguishing features are:

- it must be related to loan;
- a prefixed amount of money to be paid when due;
- a time is fixed for repayment; and
- all these elements for repayment are taken as conditions for loan.

(d) Types of *Riba*

There are two types of *Riba*, *Riba al-Nasiah* and *Riba al-Fadl*. The word '*Nasa*' means to wait and refers to the time that is allowed for the borrower to repay the loan in return for the 'premium'.

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* It is possible to take the discussion a little farther: If the last view is accepted there still remains confusion about interpretation of such Quranic and other *Shariah* statements. For example:

Fakhr al-Din al-Razi (a distinguished commentator of the Quran and philosopher) says:

"*Riba al-nasiah* (equivalent to the term used in the Quran - the author) is what was well known and conventional among the Arabs in *Jahiliyyah*. They used to give loans on the condition that every month they would receive a stipulated amount with the whole principal remaining outstanding. **Then, when the loan matured and the borrower was unable to clear his obligation, the amount was raised and the period was extended.** This is the riba that was practised in the Jahiliyyah." (as quoted in Chapra 1985, p. 244).

If one reads the statement carefully, the emphasis appears to be on the statement as shown in underlined letters. This also implies that there is an element of unjust or *Julm* embodied in the term *Riba*.

Therefore, *Riba al-Nasia* is nothing but simple *Riba* or interest as defined above. That is, suppose that X gives Tk 100 to Y for one year on condition that he will have to return Tk 100 plus Tk 10 i.e., Tk 110. This additional amount of money paid (i.e., Tk 10) is called *Riba al-Nasia.*

Riba al-Fadl, on the other hand, is encountered in hand-to-hand purchase and sale of commodities. The *Shariah* requires that if gold, silver, wheat, barley, dates and salt (i.e. 6 commodities) are exchanged against themselves, 'they should be exchanged spot and be equal and alike' or in general, the commodities should be 'like for like and equal for equal' (**Bukhari**). If X exchanges 10 kgs of good quality wheat for 11 kgs of inferior quality of the same good hand-to-hand, this would be an example of *Riba al-Fadl.* This type of *Riba* is also prohibited in Islam. The reason for prohibition is obvious. In the case of spot transactions, it may not be possible to maintain justice and fair play for both the parties. The *Shariah*, therefore, requires that the commodity for sale should first be exchanged against cash and then the cash proceeds are used to buy the needed commodity **(Bukhari).**

(e) Understanding the Basic Rationale behind its Prohibition[1]

ARGUMENTS FOR *RIBA*

- According to classical economists, interest plays a very important role in the mobilisation of savings and investment. It is said that people save in order to earn interest and investment is not possible without savings. Therefore, in the absence of interest rapid economic development cannot be achieved.
- Receipt and payment of interests and its application is very simple and hence goes to the advantages of both the payers and the takers. Each party knows how much to pay and how much to receive. There is no risk or uncertainty.

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[1] For detailed discussions on 'interest' see Habibur Rahman (1996) and Sharif Hussain (1996).

• Interest helps those families who have enough cash money but have no earning member. If these families keep their idle money in any bank, they can get an assured income every year.

• Perhaps the most fundamental argument in favour of interest is that everything has a value and time has also a value. Therefore, the borrower must pay the price of time in the form of interest.

• If the loan is used for productive purposes, the payment of interest cannot be regarded as *Julum* or exploitative.

ARGUMENTS AGAINST *RIBA*

• This argument that people save in order to earn interest is not valid in practice. If the rate of interest is zero, does it mean that people will not keep their excess money in the bank? Definitely, they will. The point is that saving is not necessarily a function of interest, rather it is a function of income. Actually, people save for the future, for unfortunate events of the future.

• The assumption of 'perfect foresight' is not possible, and hence, unacceptable in Islamic economics. Actually, the mystery of time and perfect knowledge of all affairs of the human beings including the outcome of the economic activities lies with Allah, and Allah alone. As the Quran says, **'Lo! Allah! With Him is knowledge of the Hour...No soul knoweth what it will earn tomorrow, and no soul knoweth what land it will die. Lo! Allah is Knower, Aware' [Lukman 31:34].** For example, if anybody invests Tk (say) one million, can one say with certainty how much one will get as profit--10%, 15%, 20% or something negative? The answer is hundred per cent 'No'. Therefore, simplicity is accepted at the cost of exploitation of the borrowers by the lenders in the so-called modern economy.

• The third argument is also not acceptable. In the definition of Islamic bank, it has been mentioned that it is a 'multi-institution' so that there would be some arrangements for utilising funds of those families who have no earning members. The possibility is that if the money of these types of families is properly invested under the guidance of the Islamic bank, it may even earn more income than the income provided by the fixed rate of interest.

• Time has definitely value, but it cannot have predetermined and certain value. It should be used as a variable. Therefore, the price of time should be allowed to have either positive or negative values so that the predetermined values become useless.

• Since *Riba* is an additional payment conditioned over and above the amount lent, the distinction between production loan and consumption loan or institutional loan and non-institutional loan or any type of distinction is unnecessary. For instance, the production loan based on fixed interest may also be exploitative either for the borrowers or for the lenders depending upon the actual outcome: if the profit is low or negative the borrower is exploited and if it is far above the fixed interest, the lender is exploited. Justice demands that both the risks and the gains of business should be equitably distributed between the lenders and the borrowers.

• Apart from the above arguments, there are other popular arguments against interest. For instance, interest makes the rich richer and poor poorer. This is because, banks collect deposits from thousands and thousands of small and big depositors but these funds are given as loans to only a few well-to-do business men so that funds actually get transferred (through profit) from the poor to the rich. The fixed rate of interest makes the depositors idle. A person, depositing some 25 lakh taka, according to present arrangement in Bangladesh, can earn Tk 27 thousand every month without any risk!

There are other forceful points against interest:

Interest and other leading religions

Interest has been condemned for its obvious exploitative character. From one perspective this occurs automatically because a loan is by nature without any extra charge, and a borrower is 'needy' by definition. Mills and Presley have found the following:

> 'Throughout history, usurers have been condemned for seeming to profit from the misfortune of others. Plutarch believed moneylenders to be more oppressive than foreign invaders (*Moralia*, 829), whilst the Medieval Church placed usurers in the same moral category as prostitutes, for their overt greed and lack of charity (Le Goff, 1979,

> pp35-36). Dante consigned moneylenders to the end of the seventh circle of hell in a rain of fire (*Divina Comedia.* Inferno. Canto XVII), whilst usurers from Shylock to Harpagon (in Moliere's *The Miser*) have been the butt of literary ridicule for their archetypical miserliness. They have rarely been accorded social esteem. Such universal condemnation stems from the prevalence of localised monopolies in the supply of credit, the high risk premia charged on small, unsecured loans and the potential for compound interest to render debt traps ineluctable'. (Mills and Presley 1997, pp. 2-3).

Having thoroughly discussed the issue, the authors remark: 'Islam does not have a monopoly in advocating the prohibition of interest'. (Ibid. p. 1).

Interest and money

Interest has perennially been attacked for contravening the original intentions behind the institution of money. The original intention behind the creation of money was not to act as source of gain but as a medium of exchange. Notably, 'Aristotle regarded usury as the ultimate abuse of money by treating it as a means of profit rather than as a facilitator of exchange.' (Ibid., p. 5).

Interest and public debt

In the capitalist economy, money is treated as a commodity and hence assumed to have a price. This price is known as interest. That interest in the world economy is acting as powerful instrument of injustice can be ascertained from the following:

> 'Over the years the public debts of low income economies had accumulated to over $426 billion by 1991. Since 1982 the amount of aid flowing into the developing countries has been less than the amount being paid out by those countries in the form of interest and principal.... This means that there is a net resource outflow from the poor countries to the rich counties...' (Akram Khan 1994, p. 12).

Interest and inflation

What is the nature of relationship between interest and inflation? Untill now the conventional economists believed that

interest and inflation had an inverse relationship. This belief had actually led the policy makers to raise interest rate to combat inflation. However, recent research studies have shown that inflation and interest are directly related (Flexner 1989, p. 78). This can be explained by the fact that when the interest enters into the cost of production and the corporations recover it through increased price of output. In other words, the corporations can shift the burden of interest on the consumers because of the economic power it enjoys in fixing the price level.

Interest and environment

Akram khan points out that interest plays an important role in vitiating and polluting the environment. Since the poor countries are under immense pressure to repay theirs debts with interest, they can not but overuse their soil and strive to increase their exports for which they are compelled to mine their environmental resources more deeply.

(f) Differences between *Riba* and Profit

There are people who, either willingly or unwillingly, try to equate profit with interest. It must be borne in mind that these two concepts are fundamentally different. The basic differences between these two concepts are noted as under.

Chart-1
Distinction between *Riba* and Profit

RIBA	PROFIT
(1) By definition, *Riba* is the premium paid by the borrower to the lender along with the principal amount as a condition for the loan;	(1) By definition, profit is the difference between the value of production and the cost of production;
(2) It is prefixed, and hence there is no uncertainty on the parts of either the givers or the takers in so far as its amount is concerned;	(2) It is post-determined, and hence its amount is not known until the activity is done.
(3) *Riba* cannot be negative, it can at best be very low or zero;	(3) Profit can be positive, zero or even negative;
(4) From the Islamic *Shariah* point of view, it is *Haram*.	(4) From the Islamic *Shariah* point of view, it is *Halal*.

2. ISLAMIC BANKING: WHAT AND WHY?

(a) Background

The background of an Islamic bank as we find to-day in both the Muslim and non-Muslim world can be traced through the ideological and Islamic economic development viewpoints.

(i) From ideological viewpoint

The evolution of Islamic bank owes its origin to the Quranic dictate i.e., **'Allah hath permitted trade and forbidden *Riba*' [Baqara 2:275].**[2] This contains two instructions, one positive and the other negative. Positively, it means that the people are allowed to do trading which implies exchange of money for goods and services and, in turn, exchange the same for money, the difference between the buying and selling prices being regarded as 'profit'. Negatively, it means that *Riba* is prohibited i.e., exchange of money for money with a prefixed premium for waiting as the condition for the exchange, is not allowed. But as Chapra says, 'Any attempt to treat prohibition of *riba* as an isolated religious injunction and not as an integral part of the Islamic economic order with its overall ethos, goals and values is bound to create confusion' (Chapra 1985, p. 64). Then what else do we need?

Like the conventional banking, the basic functions of an Islamic bank are to accumulate funds and invest them in different income-earning activities within the framework of Islamic *Shariah.* This implies that, to be an Islamic bank, at least two other *Shariah* restrictions will have to be abided by. These are explained as under.

First, all prohibited activities will have to be avoided. Some of the restricted items are purchase and sale of pork, alcohol and alien commercial films.

Second, the Islamic *Shariah* demands that while accumulating and allocating funds, *Riba* must be avoided.

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[2] There are many *Hadiths* of the Prophet, which have condemned the practice of *Riba* in stronger terms.

(ii) From Islamic economic development viewpoint

Now the question arises: When any financial institution gets involved in trading in the way described above, can we call it a 'bank'? We can not. In modern economic terminology, a bank is defined as a financial institution, which keeps money (and valuables) safely and honour checks drawn upon them. This is very important from the point of view of Islamic economic development. Therefore, a bank worth its name must also perform the usual banking functions.

We can again ask: if a financial institution gets involved in trading activities and performs the usual banking functions, can we name it an **'Islamic Bank'**? Perhaps, again, not. Given the characteristics as described above, the institution may at best be called **'Islamic Business Bank'** or **'Islamic Commercial Bank'.** If Islamic bank is to serve as an alternative institution to the conventional banking system, it must also perform the other vital functions of the modern banking system. That is, it must play the role of a development bank too. This means that the bank must participate in the production activities: certainly one can not engage in buying and selling activities unless the goods and services are produced. The Islamic banks must perform these functions because, the conventional banking system 'has been a major instrument in the drive for unrealistic growth rates and one of the principal sources of not only unjust income distribution but also economic instability' (Chapra 1985, pp. 28-29). Therefore, as Chapra goes on to say, 'The challenge faced by the Muslim countries is how to design and run a money and banking system that is in harmony with the nature of Islamic ideology, eliminates *riba,* and helps realise the socio-economic goals of Islam' (*Ibid*, p. 28). The statement has added the development content of the Islamic bank, a gigantic task indeed!

According to Ziauddin Ahmad (1991, p. 156), the Islamic socio-economic goals include eradication of poverty, equitable distribution of income and wealth and sufficient opportunities for gainful employment. Among others, the goals as mentioned by Chapra (1985, p. 34) are: socio-economic justice and equitable distribution of

income and wealth, mobilisation and investment of savings for economic development in an equitable manner such that a just return is ensured to all parties concerned, and effective rendering of all services normally expected from the banking system. Mannan has listed some other interesting goals of Islamic banks. Some of these are: mobilising intellectual human resources through training and re-training, mobilising non-human resources, emphasising not merely the distribution of income but also the distribution of powers and responsibilities, and providing an institutional framework for pooling and utilising financial and non-financial voluntary resources (Mannan 1984, p. 414).

(b) What is an Islamic Bank?

According to OIC (Organisation of Islamic Conference), Islamic Bank is defined 'as a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic *Shariah* and to the banning of the receipt and payment of interest on any of its operations'. This definition was accepted in the Foreign Ministers' Conference of the Muslim countries held in Dakar, Senegal, in 1978. Undoubtedly, this definition unfolds the fundamental philosophy of an Islamic bank, but it does not appear to be a complete one. Banning of interest is not all that is wanted from a true Islamic bank; Islamic economics expects something more out of it. In the true sense of the term, as some experts would appear to believe, Islamic bank is not akin to *interest-free* bank. It is more than that. It is rather an institution through which *Adl* (justice) and *Ihsan* (kindness) are established in the society.

Against the background as described above, it is possible to give a comprehensive definition of an Islamic Bank: **'It is a multi-form financial institution which conducts its activities according to the principles of Islamic *Shariah*, banning of *Riba* in particular, in all its operations and help achieve the socio-economic goals of an Islamic society'.** Notably, the term 'multi-form' is added simply to emphasise the fact that the Islamic banking may not necessarily

refer to only a purcly commercial institution, it should also refer to a development institution and does not overlook the importance of *adl* and *Ihsan*. It integrates the social, economic and spiritual values and, among others, while making investments serves the interests of both the investors and those of the local community. What is not possible for a special type of Islamic bank to do, it should be possible for the entire Islamic banking system.

(c) The Comprehensive Picture of a True Islamic Bank

On the basis of the above analysis, we can now draw the expected picture of a true Islamic bank:

(a) **From ideological viewpoint:** A true Islamic bank runs all its activities strictly on the principles of Islamic *Shariah*. In particular:

(i) nowhere in its operations, *Riba* is allowed to transgress; all funds are collected and investments made purely on the basis of the modes permitted by the *Shariah*; and

(ii) all activities in which Islamic banks participate are *Halal*.

(b) **From socio-economic development viewpoint:** An Islamic bank through its various activities helps economic development and at the same time ensures justice and kindness in the society, which demands, among others:

(i) mobilisation of savings;

(ii) effective utilisation of available resources;

(iii) providing the usual banking services efficiently and diligently;

(iv) giving proper emphasis on the agricultural sector (if the country in question is basically agricultural in nature);

(v) development of human resources through training and re-training;

(vi) mobilisation of non-human resources, including *Zakat* and *Sadaqa;*

(vii) establishment of justice and equitable distribution of income and wealth; and

(viii) integration of the roles of commercial, development as well as a welfare-oriented banks.

It should be understood that the above mentioned features are meant for the Islamic banking system as a whole; it is not expected that a single Islamic bank would have all the features. Again, it should be made absolutely clear that the first three criteria directly relates to the traditional banking system and the rest are the features of the Islamic banking system. The philosophy is that while mobilising savings, utilising available resources and providing the usual banking functions the Islamic banking system must see that the fruits of their efforts are properly distributed in the society and that the human resources are properly trained so as to enable them to perform their responsibilities as bankers in the Islamic banking system. In other words, what is emphasized here is that the rest of the criteria must be built-in into the first three criteria.

3. OPERATIONAL MODES

Although both the Islamic and conventional banks perform the same basic functions i.e., accumulation of funds and investing the same in different income-earning activities, their nature and extent are significantly different. In particular, they differ in their operational modes, types of investment activities and more importantly, in the objectives they want to achieve. While the conventional bank aims at maximising income, the Islamic bank aims at the same but subject to socio-moral constraints. This section shows how the Islamic banks accumulate their funds, mobilise deposits and the modes they adopt in utilising their funds.

(a) Modes of Accumulation of Funds

Modes of accumulation of funds of Islamic banks are similar to those of conventional banks. This includes paid-up capital, reserved funds, other savings and undivided profits, loans from banking system and deposit made by the general public. Of these, the mobilisation of deposits is perhaps the most important and crucial. There are several

modes through which Islamic banks try to mobilise funds or savings. These are explained below.

(i) *Al-Wadia* account

Al-Wadia is an important *Shariah* permitted mode of Islamic banks through which deposits are mobilised. The account in which the collected money is deposited is known as *Al-Wadia* Account, which resembles the Current Account of the conventional banks. People deposit their money in this account mainly for safe custody. The usual conditions include: (1) the depositors can deposit and withdraw any amount of money without any restriction, (2) the money deposited in this account neither earns any profit nor incurs any loss, and (3) the bank is authorised to utilise the money for its own benefit but at its own risk.

When people make deposit purely for the reward in the Hereafter, i.e. to respond to the call of Allah, '**Who is he that will lend a goodly loan (a loan without interest or any thought of gain or loss), that He may double it for him and his may be a rich reward' [Hadid 57:11]**, this mode is then called *Qard Hasan* Account. The conditions for operating the account may remain the same as for *Al-Wadia.*

(ii) *Mudaraba* account

For the mobilisation of deposits, this is the most important mode of the Islamic banks. The account in which the money is deposited is known by its name i.e., *Mudaraba* Account or PLS Account and resembles Savings Account of the conventional banks. Under this principle, the bank accepts deposits from the public with the authority to manage the funds. The resulting profit is shared by the bank and the depositors according to a pre-agreed ratio and the loss, if any, not resulting from the negligence of the bank, is borne by the depositors. The *Mudaraba* Account may be of two types, normal account and term account. In the former case, the depositors (like the Savings Account) can deposit any amount but can withdraw the

money under some restrictions only. The term deposits may vary from 6 months to 5 years. It may be mentioned that the longer the time period, the higher the rate of profit offered.

(b) Modes of Allocation of Funds

Mere mobilisation of funds is of no use to the bank until they are used for profitable business or activities. For the conventional bank the usual mode is 'interest'; but for the Islamic bank this mode is unavailable due to restriction of the *Shariah* ; it has several alternative modes, however. The profit earned by the bank is determined by the types of the mode used. It is, therefore, essential to examine the most popular modes of investment of the Islamic banks in the modern age.

For ease of exposition, the investment modes are classified into four groups viz., (i) Lending modes; (ii) Trade-related modes; (iii) Participatory modes, and (iv) Service-oriented modes. The most important modes of each category are discussed below.

(i) Lending modes

(1) *Qard Hasan*: *Qard Hasan* or loan without any charge whatso ever owe its origin to the Quranic dictate as stated above. By definition, no profit is added to this. However, the loan-giver may charge a small fee to cover the expenses incurred in handling the loan. If this is the case, this mode may be called 'Loans on Service Charge'. In Pakistan, this service charge is about 3 per cent, which is much less than the usual rate of interest (say, 16%).

From the viewpoint of distribution, this method is very good; but since it earns no profit, this is bad from the viewpoint of the bank's sustainability: This method should, therefore, be used only as a very special case. Some examples are: (i) securing the means, tools and others accessories required to create employment possibilities for these people who lack such opportunities, (ii) helping to increase production with due emphasis on agriculture, livestock, fisheries and small and cottage industries, and (iii) meeting essential needs.

(2) Loans on normal profit: In a country where most of the people are poor and illiterate, this method i.e., loans on the basis of normal profit can be used. There is however one danger here. What is a normal rate of profit? How do we determine it? Normally, the Islamic economists suggest the name of an agency called *'Hijbah* Agency' which, on the basis of up-to-date information, declares different 'normal' rates of profit for major activities at the beginning of each year. Loans are then given on the basis of these rates. The condition is that if at the end of the year, the actual profit comes out to be lower than the rate used, the bank returns the excess amount taken, and if it is just the opposite, the clients return the extra money willingly.

This mode of financing is very simple, but may be very difficult to implement in a situation where the system of estimating 'normal' profit is liable to be faulty and controversial. Islamic economists are of the opinion that at the initial stage it is better to avoid this mode.

(ii) Trade-related modes

(3) *Bai-Muajjal and Bai-Murabaha*: The word *'Ajjal'* means 'to defer' i.e., to delay the payment. *Bai-Muajjal* means sales on deferred payments. Under this mode, the bank buys the goods required by the clients, adds profit on mutual consultation and hands over the goods to them. The clients, according to the agreement reached, repay the price of the goods either by instalments or at a time after certain date. The mode is called *Bai-Muajjal* or *Bai-Murabaha* (i.e., sale at cost plus profit) depending upon whether the bank is under obligation to inform the clients the purchase price of the goods and the amount of profit (or Mark-up) added. If the bank lets the clients know both the price of goods and the margin added, the method is called *Bai-Murabaha,* if not, the method is called *Bai-Muajjal.*

This is a very popular mode of investment of the modern Islamic banks and can be employed in almost all types of business activities. It is very simple and does not involve any complication either on the part of the clients or on the part of the bank. However,

this method may often be misapplied so that it goes very close to 'interest' which is condemned in Islam. The dangerous situation arises when the bank allows the clients to buy the required goods themselves, makes only the paper transactions and adds the profit or margin on it.

(4) ***Bai-Salam*:** This is just the opposite of *Bai-Muajjal* as explained above. '*Bai-Salam*' means advance purchase. Here, the bank makes the advance payment for the goods to be delivered by the clients at some future date. While fixing the price, the interest of both the parties (i.e., the bank and the clients) are carefully considered. This mode can be used for financing agricultural inputs like shallow tube wells and deep tube wells and industrial raw materials. That is, the bank pays for the inputs now and gets the produce (say paddy) after the harvesting season. In order to make this mode socially beneficial, the bank (the financing side) must be very sincere in fixing the price of goods.

(5) **Hire purchase:** In this case, the bank becomes the owner of the properties like houses and irrigation devices and rent them out to clients on the conditions that they pay the fixed rent per month/season plus a fixed proportion of the total sale price of the property concerned. After the payment of the whole amount, the property in question is transferred to the clients. This is the only popular mode through which the clients can hope to become the real owner of the property. For small savers, it is a very useful mode.

(6) ***Ijara*:** The *Ijara* mode is almost similar to the hire- purchase mode. The only difference is that in the later case, the clients do not have any scope to become owners of the property taken; he can use only the property as long as he pays the rent. For the bank, this mode provides an assured source of income. It involves little calculation and the element of risk is also small.

(iii) Participatory modes

Of the modes available to the Islamic banks, this type of mode is perhaps the most important one. The modes specified under this category are directly related to the socio-economic development of the country. Some of the investment-type modes are discussed below.

(7) ***Musharaka***: *'Musharaka'* means partnership. There are two partners- the bank and the clients or the entrepreneurs. They agree to contribute their mutually agreed share to their capital required for operating the business, share profit in an agreed ratio and share loss in the proportion of their capital employed in the business.

This method, if properly administered, is free from all sorts of confusions, doubts and criticisms as raised against some of the trade-related modes. However, this mode of investment has some preconditions before it gets application: (a) the partners must maintain detailed accounts of their business; (b) the partners (particularly, the clients) must have good moral character, otherwise there would be wilful underestimates of the profit account and overestimates of the cost accounts; and (c) the bank must have sufficient number of well-trained staffs to look after each and every project undertaken jointly.

(8) ***Mudaraba***: *'Mudaraba'*, like *Musharaka,* is also a partnership business. However, there is a fundamental difference. In the case of *Mudaraba,* the bank provides the entire amount of capital needed to run the business and the client provides the entrepreneurial services and the other necessary inputs. The profit is shared between these two partners according to the pre-agreed ratio; but the loss is borne by the bank, the supplier of capital, alone. The client loses his labour only. However, if on investigation, it is found that the loss was due to the negligence of the clients, the bank may not agree to bear the whole burden. *Mudaraba* financing can be undertaken by banks, individual private investors, groups of private investors or investment companies.

(9) Purchase of shares: Islamic bank can purchase shares from the share markets. If properly managed, this can be regarded as a good

source of income. There is, however, one danger in this case. As Islamic bank is allowed to enter into *Halal* business only, in selecting company or companies it has to be very careful and see whether the selected company's activities are permitted by the *Shariah*. If not, it cannot do any transactions with it/them.

(10) Direct investment: Finally, without taking any assistance from a third party, the Islamic bank can itself run a business, or establish industrial enterprises. Starting from making a project down to the production and sales management the bank remains responsible alone. This mode, although sounds very good, should be used only when the bank has requisite number of well trained and experienced staff.

(iv) Service-oriented modes

In addition to the above, Islamic banks also undertake service-oriented modes. This mode is materialised through the principle of 'co-operation'. As Chapra very nicely propounds, 'With the emphasis of Islam on brotherhood, 'co-operation' in its various forms to solve the mutual problems of producers, businesses, consumers, savers, and investors should receive considerable emphasis in an Islamic society' (Chapra 1985, p.75). The forms of co-operation may include such areas as temporary financial accommodation when necessary through mutual fund, the economies of bulk purchases and sales, maintenance facilities, advisory services, assistance or training for solving technical and managerial problems, and mutual insurance.

(v) An overview of Islamic Financial Modes

Before leaving this section, it may be useful to say a few words about comparative position of different Islamic modes as described above. This is shown in terms of a Chart 2 below. The criteria used are 'risk' and 'return'.

Chart 2

The Comparative Position of Different Islamic Modes

Mode \ Criteria	Nature of Mode	Nature of Risk	Nature of Return
Qard Hasan	Lending	Low	Nil
Loans on normal profit	Lending	Low	Fixed
Bai-Muajjal	Trade	Low	Fixed
Bai-Murabaha	Trade	Low	Fixed
Bai-Salam	Trade	Moderate	Fixed
Hire Purchase	Trade	Low	Fixed
Ijara	Leasing	Moderate	Fixed
Musharaka	Participatory	High	Uncertain
Mudaraba	Participatory	High	Uncertain
Purchase of Shares	Participatory	High	Uncertain
Direct Investment	Participatory	High	Uncertain
Service oriented	Service	Nil	Fixed

A NOTE ON THE CALCULATION OF PROFIT AND ITS DISTRIBUTION

The method of calculation of profit and its distribution procedures among the shareholders and depositors in the Islamic banks are simply unique. It would be quite interesting to illustrate the method with a hypothetical example as depicted in Table 1:[3]

[3] The figures are collected from Awwal Sarker (1998).

Table 1
Calculation of Profit and Its Distribution of an Islamic Bank (Hypothetical)

Sources of Funds	Total Annual Deposits (Product)	Weightage	Weighted Product (col.2xcol. 3)	Implied Rate of Profit (%)	Distribution of Profit (col.2xcol. 5)
1	2	3	4	5	6
1. PLS term deposit accounts					
a: 3 years	3500	1.00	3500	12.43	435.11
b: 2 years	700	0.90	630	11.19	78.32
c: 1 year	3200	0.80	2560	9.95	318.25
d: 6 months	200	0.75	150	9.32	18.65
2. PLS savings deposits	9800	0.70	6860	8.70	852.82
3. PLS short-term deposits	400	0.35	140	4.35	17.40
Sub-total	17800	-	13840	-	1720.55
4. Paid-up apital	800	1.00	800	12.43	99.45
TOTAL	**18600**	-	**14640**	-	**1820.00**

Explanations of the contents of the table are given as under.

(1) It is assumed that the Islamic bank procures funds from two sources: paid-up capital and deposits from the public. The amount of paid-up capital is Tk 800 and that of various deposit accounts is Tk 17,800. The bank maintains savings deposits, short-term deposits and four types of term's deposits. The amount of deposits from various accounts is shown in column 2.

(2) It is assumed that the bank earns an investment-income of Tk 2,600. In every year, the Board of Directors decides to distribute the profit according to an agreed principle. The proportion of profit allotted to deposit holders normally varies from 65 to 70 per cent. The most typical principle is as follows:

- 66.18 per cent to PLS depositors (Tk. 1,720.55)
- per cent to providers of paid-up capital (Tk 99.45)
- 70.00 per cent in total (Tk 1,820.00)
- 20.00 per cent to meet management cost (Tk 520.00)
- 10.00 per cent to reserve fund (Tk 260.00
- 100.00 per cent in grand total (Tk 2,600.00)

Using these proportions, the reader can verify that Tk 2,600 gets distributed as per amounts shown within brackets.

(3) How to distribute Tk 1,720.55 among the different types of account holders? For this the bank uses a weightage system. That is, each account is given appropriate weight considering its duration. The typical weights are shown in column 3. Note that 3-year term deposit is given the highest weight (1.00) and PLS short-term deposit accounts the lowest weight (0.35).

(4) In column 4, weighted product is calculated (col. 2 x Col. 3).

(5) How the rates of profits for different types of accounts are calculated? The inquisitive readers have already noticed that for a deposit of Tk 13,840 (weighted product, Col. 3 i.e. total of 3 types of deposit accounts), a profit of Tk 1,720.55 has already been declared. This implies the rate of profit as 12.43%. Once this is accepted the other rates are easily obtained by using the weights as shown in column 2. The calculated rates are exhibited in column 5.

(6) How much is the amount of profit in each account? This is obtained by multiplying the rate of profit (col. 5) with the appropriate amount of original deposits as shown in column 2. The calculated profits are shown in column 6 of the above table.

4. ISLAMIC BANKS AND CONVENTIONAL BANKS: A COMPARISON

It would be of importance to make a comparison between the basic features of Islamic Banks and those of conventional banks. This is shown in the following chart.

Chart 3
Comparison between Conventional and Islamic Banks

Conventional Banks	Islamic Banks
1. The functions and operating modes of conventional banks are based on man-made principles.	1. The functions and operating modes of Islamic banks are based on the principles of Islamic *Shariah*.
2. The investor is assured of a predetermined rate of interest.	2. In contrast, it promotes risk sharing between provider of capital (investor) and the user of funds (entrepreneur).
3. It aims at maximising profit without any restriction.	3. It also aims at maximising profit but subject to the *Shariah* restrictions.
4. It does not deal with *Zakat*.	4. It is one of the service-oriented functions of the Islamic banks to collect and distribute *Zakat*.
5. Lending money and getting it back with interest is the fundamental function of the conventional banks.	5. Participation in partnership business on PLS basis is the fundamental function of the Islamic banks.
6. Its scope of activities is narrower when compared with an Islamic bank.	6. Its scope of activities is wider when compared with a conventional bank. It is, in effect, a multi-purpose institution.
7. It can charge additional money (compound rate of interest) from defaulters.	7. Islamic banks have no provision to charge any extra money from defaulters.
8. In it very often, individual interest becomes prominent. It makes no effort to ensure growth with equity.	8. It gives due importance to the public interest. Its ultimate aim is to ensure growth with equity.
9. For interest-based commercial banks, borrowing from the money market is relatively easier.	9. For Islamic banks, it is comparatively difficult to borrow from the money market.

Conventional Banks	Islamic Banks
10. Since income from the advances is fixed, it gives little importance to developing expertise in project appraisal and evaluations.	10. Since it shares profit and loss, Islamic banks pay greater attention to developing project appraisal and evaluations.
11. It gives greater emphasis on credit-worthiness of the clients.	11. It gives greater emphasis on the viability of the projects.
12. The status of a conventional bank, in relation to its clients, is that of creditor and debtors.	12. The status of Islamic bank in relation to its clients is that of partners, investors and trader.
13. A conventional bank has to guarantee all its deposits.	13. Strictly speaking, an Islamic bank can not do that.

5. ROLE OF ISLAMIC CENTRAL BANKING

The discussion on Islamic banking system cannot be complete without any reference to the role of central banking in an Islamic framework. The central bank is in essence the pivot of the Islamic banking system. It is generally believed that the functions and responsibilities of the Islamic central bank would be similar to those of the conventional central bank. Strictly speaking, this is not true. The objectives, mechanics, power and the scope and responsibilities of the Islamic institutions would be quite different. The role of Islamic central bank can be seen from its functions and responsibilities as discussed below.

(a) Normal Functions

The Islamic central bank is to perform the normal functions of a conventional central bank. These are as follows:

- It issues currency notes and, in co-ordination with the government, remains responsible for maintaining its internal and external stability.
- It acts as the bankers' bank and also as the bank of the government.

- It performs the function of a clearing house i.e., makes arrangements for clearance and settlement of cheques of commercial banks.
- Like the conventional central bank, it acts as the lender of the last resort.

(b) Supervisory Functions

Although both the conventional and Islamic central banks bear the responsibility of supervising, guiding and regulating the commercial banks, the importance of this function for the latter is more intense. This is because of the greater risk involved in the Islamic system. The Islamic banks share the risks and uncertainty with the clients in their business. It is the additional responsibility of the central bank to see that the commercial banks do not indulge in financing speculative or unduly risky ventures.

(c) Special Functions

In addition to the above-mentioned functions, which are performed more or less by the two types of the central banks under consideration, the Islamic central bank has to bear some other very crucial responsibilities. Some of these are:

- As the country enters into the Islamic banking world, it becomes indispensable on the part of the central bank to study and review the existing laws related to interest-based financial institutions and amend or reconstruct them in the light of the Islamic *Shariah*. Among others, the law should authorise the central bank: (a) to prescribe the minimum capital and reserve requirements and liquidity ratios in accordance with the nature and extent of deposits and assets of the commercial banks; (b) to lay down sufficient safeguards in order to ensure the safety of the depositors' funds, and (c) to see that the funds of the banks are not mishandled by the management of the banks.
- Under the Islamic banking system, the central bank gives directives regarding the purposes for which financing may or may not be made, the maximum limits of such finance, the cash margins to be

maintained and the ratio of collateral to be obtained in the case of such financing.

- The central bank makes arrangements for the training of officers and other employees of the banks in accordance with Islamic principles.
- It ensures that the adopted policy package does not help concentration of wealth in the few hands.
- Finally, the central bank 'should be allowed to raise income through (i) service charges levied on the government, the commercial banks and other financial institutions for various services rendered to them and (ii) investment of statutory reserves maintained by the commercial banks' (Chapra 1985, pp.153-54).

In conclusion it should be added that while discharging its supervisory functions, the central bank should guard against the danger of becoming overly restrictive in its outlook. Its true role should be 'Just like a mother, it will have to conceive, prepare for the birth, nourish, educate and help the Islamic banking system to grow'. (*Ibid*, p.153).

6. SOCIAL INVESTMENT BANK LIMITED: AN OVERVIEW

The Social Investment Bank Limited (SIBL*), a brainchild of Dr. M. A. Mannan, one of the pioneers in the field of Islamic economics, has been established in Bangladesh in 1995. This is a Three Sector Unique Model Joint Venture Bank. Its objectives, scope of activities, and its operational strategies are, in a sense, quite different from other Islamic banks operating in Bangladesh. It would naturally be of some interest to devote some space for this particular venture.

(a) Objectives

The SIBL is the only bank, which operates on the basis of integrated three-sector model. These sectors are: (i) **Formal Sector,** (ii) **Informal Sector** and (iii) **Voluntary Sector.** The ultimate goal of

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* The bank changed its name to Social Islamic Bank Limited in 2009.

the model is to achieve participatory economy and sustainable social development with appropriate institutional development for a caring society. The sector-wise specific objectives are:

For the formal sector	: To humanise
For the informal sector	: To socialise
For the voluntary sector	: To monetise

(b) Scope of Activities

Since this involves three sectors, in a sense the whole economy, it is quite natural that its scope of activities would be much wider than that of any other similar institution working in any country. A brief description of the activities of these three sectors is provided below.

(i) Formal sector

In this sector are provided the usual commercial banking services and resembles any other Islamic bank in the country. Among others, it offers the most up-to-date banking services through opening of various types of deposit and investment accounts, financing trade, providing letters of credit guarantee, opening letters of credit, collection of bills, effecting domestic and international transfer, leasing of equipment and consumers' durable, hire purchase and instalment sale for capital goods, investment in low-cost housing and management of real estates, participatory investment in various industrial, agricultural, transport, and educational and health projects.

In addition, the bank aims at providing some special services for the Bangladeshis. These include managing foreign currency accounts, providing express home remittance services, introducing Co-operative Investment Schemes, and Foreign Wage Earners' Rehabilitation Schemes.

Since, this is expected to operate in terms of profit-and-loss sharing, the formal sector will ultimately work as an **Islamic Participatory Commercial Bank.** The feature that distinguishes it from similar financial institution is that it would, through various

activities, strive to generate, what is called, **Social Surplus,** part of which would go directly to relieve human misery. This is what humanising the formal sector means.

(ii) Informal sector

This sector involves informal financing in the non-corporate sector. Most popularly, the informal sector include such activities as petty traders, street hawkers, shoe-shine boys and persons employed in the periphery of the urban areas. According to Mannan, an informal sector should have the following characteristics:

- ease of entry,
- reliance of indigenous resources,
- family ownership of enterprises,
- small scale of operation,
- labour intensive adapted technology,
- skills acquired outside the formal school system,
- unregulated and competitive markets.[4]

The activities of this sector mainly revolve round the micro-credit as are being done by such specialised institutions as the Grameen Bank and Non-Government Organisations. The activities are carried out without interest but employing Islamic methods of operations. Among others, the sector involves in opening and introducing various savings and micro-credit investment and custom-tailored group programmes, designed for small entrepreneurs, marginal farmers, landless labourers, and unemployed educated youth/semiskilled people.

Mannan identifies two new schemes, unlike the ones we have in Bangladesh, for the non-formal sector. These are Group Lending Scheme (GLS) and Rotating Savings and Credit Associations (ROSCA).[5]

The non-formal sector is, in a sense, a **Non-formal Banking with the Poor** with a view to empowering and socialising the poor family of rural and urban areas. A part of the social surplus generated

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[4] See Mannan (1998, p.8)

[5] *Ibid* pp. 9-11.

in the formal sector will go directly to support the poor in their efforts to become self-dependent, thus linking the formal and informal sectors. The income-generation in the rural sector is expected to discourage internal migration.

(iii) Voluntary sector

This represents new avenues in the banking arena and makes the SIBL a truly unique model in this field. Among others, this sector involves in the development and management of *Waqf* and Mosque properties, management of inheritance properties. joint-venture projects for management of *Hajj* affairs, development and management of non-profit foundations, charitable trusts and organisations, and development and management of funds involving welfare of women and non-Muslim minorities.

The voluntary sector of the SIBL, in the true sense of the term, represents a **Development Bank** because through the various activities of this sector, the Bank intends to monetise the whole sector.

(c) Strategies

The basic strategies of operations for the three sectors are as follows:

For the formal sector: Providing corporate finance through competitive market mechanism to the relatively richer section of the society. This would mainly concentrate in the urban areas.

For the informal sector: Providing non-corporate finance through custom tailored micro-credit package to urban and rural poor.

For the voluntary sector: Providing both corporate and non-corporate finance to the development of *Waqf*, Mosque and inherited properties and the aspects of the third sector of the economy.

(d) Operational guidelines

There are at least three guidelines that are given for allocating resources. These are:

- Triple preferences: economic, social and moral preferences to be 'transparent and revealed' in all operations;
- Linking financial/economic entitlements to social assignments; and
- Duties should define rights.

Thus at the operational level, all three sectors' activities would be mutually interdependent and collectively reinforcing through contribution to Social Fund and Social Assignment Schemes linked with Social Entitlement, thereby making all these activities economically, socially and ethically transferred and revealed.

The following Chart presents the summarised view of the inter-dependent and mutually reinforcing strategies of sectoral operations of the SIBL.

Chart - 4
Operational Guidelines of SIBL

Scope of Sectoral Operations	Basic objectives	Basic Strategies of Operations	Locations of Operations	Key Emphasis and guidelines of Operations	Effect of the Overall Operations	Ultimate Goal of the Overall Operations
Formal Corporate Sector	Humanise the Formal Sector	Providing corporate finance through competitive market mechanism to the relatively richer section of the society	Mainly in the urban setting	*Triple preferences: economic, social and moral preferences to be 'transparent and revealed' in all operations *Linking financial/economic entitlements to social assignments *Duties should define rights	Strengthening the family and family chain for a better future generation	Participatory economy and sustainable social peace for a caring society
Non-formal Non-corporate Sector	Socialise Non-formal Sector	Providing non-formal corporate finance through custom tailored micro credit package to the urban and the rural poor	Both in urban and rural setting	*Triple preferences: economic, social and moral preferences to be 'transparent and revealed' in all activities *Linking financial/ conomic entitlements to social assignments *Duties should define rights	Empowering the family by creating income opportunities for the poor	Participatory economy and sustainable social security for a caring society
Voluntary Third Sector	Monetise Third Sector	Providing both corporate and non-corporate finance to the development of the third sector of the economy	Both in urban and rural areas	*Triple preferences: economic, social and moral preferences to be 'transparent and revealed' in all activities *Linking financial/ conomic entitlements to social assignments	Re-empowering the socio-economic institutions for redistribution of income and human need fulfilment	Participatory economy sustainable institutional development for a caring society

Through these activities, the proponent of this new venture sincerely believes that it would be possible to create a New School of Negotiated and New Participatory Economics of the 21st century and

beyond. It is also expected to give birth to triple revealed preference theory of Social Income, Social Distribution and Social Peace for a caring society. Further, it is also believed that, this will lead to **Rewriting New Social Contract** based on the assumption that man is born with obligations. As such his duties should define his rights. This is actually the basis for linking financial entitlements to social assignments as shown in the chart given above.

(e) Some Observations

Given the above ingredients of the SIBL three-sector model, some observations can be made:

(i) The points that are commendable

First, the SIBL is the only bank that proposes to deal with the multifarious types of activities that are needed not only to achieve the overall development of the economy but also to enable all types of persons to get the fruits of development. This is the only bank that aims to develop all traditional and non-traditional activities of an economy. In a sense, it is not a bank, it is much more than that.

Secondly, this is the only institution that has made an explicit commitment to targeting poverty, emphasising preferences to economic, social and moral aspects and linking financial entitlements to social assignments.

Thirdly, although the SIBL proposes to deal with micro credit, its operational mechanisms are not necessarily the same as found in the Grameen Bank and other NGOs. For example, the Grameen Bank gives loans to the poor women. This strategy is very often seen as responsible for braking the family in the rural areas. The SIBL, in contrast, proposes to provide loans on PLS system for **empowering the whole family.** In other words, in the SIBL, family is taken as basic social unit.

Fourthly, the introduction of the Neighbourhood Allowance Scheme or offering concessional financing of consumer durables to the dowry-free newly married couples for humanising the formal sector, beginning of Environmental Friendly Business Programme with small traders of TOKAI (mostly street children) for socialising the informal sector, and introduction of Cash Waqf Certificate for

monetizing the voluntary sector, will definitely go a long way in integrating economic, social and moral values and open up eyes for the other Islamic banks to follow suit.

(ii) The points that need either elaboration or fresh thinking

The points that need elaboration or fresh thinking are buried in the above points. That is:

First, the proposal for combining the normal commercial services (that is meant mainly for the urban rich), micro-credit (that is meant mainly for the target people like landless labourers, marginal farmers and small entrepreneurs) and development and management of third sector services give rise to many operational issues. For instance, the cost per unit of fund invested in the case of the formal sector and the informal sector will be far different, the latter would be much higher than that of the former. In order to keep the cost down, the official arrangements may have to be different for these three sector activities. The actual operational issues need to be spelt out. In effect, the integmtion of the proposed 3 sector need detailed guidelines than so far been attempted.

Secondly, the model proposes for the integration of the economic, social and moral values. This is the most important task for Islamic economic institution such as Islamic bank. The SIBL needs to elaborate this point for the understanding of the general readers.

Thirdly, the model gives emphasis on the family as the basis for business. This is also not clear how this would be operationalised. In the case of big wilful default of the borrowing member how the other members of the family would help realise the money.

Fourthly, the bank has (now fifteen) been operating for over five years. It is advisable that it makes an independent but meaningful evaluation by the experts so that the inner obstacles can be identified and practical steps be taken for overcoming them.

REFERENCES FOR FURTHER REDING[6]

1. Umar Chapra (1985), 2. M. Sharif Hussain (1996), 3. Shah Muhammad Habibur Rahman (1996), 4. M. A. Mannan (1998)

[6] For details, see the list of references given at the end of the Book.

Chapter 12

ISLAMIC BANKING : PRACTICE

[**Key Concepts:** IDB – equity financing – lease financing – absorptive capacity – statutory reserve ratio – *Adl* and *Ihsan* – profitability – productivity – liquidity – distributive efficiency – banking inequality index – investment-client development programme – Islamic Financial Instruments]

This chapter is devoted to an analysis of the applications of the mechanisms of Islamic banks. There are three sections, the first section deals with Islamic banks around the world, the second with the Islamic Development Bank and the last one with the evaluation of Islamic banks with reference to Bangladesh.

1. ISLAMIC BANKS AROUND THE WORLD

From the literature it is found that the first attempt to implement the principles of Islamic banking was made in Malaysia in the name of Pilgrimage Savings Corporation in 1963. In the following year, Egypt established a true Islamic bank namely, 'Savings Bank'. This bank was established at the initiative of Ahmed Abdulaziz Al-Naggar. At the initiative of the government, 'Tabung Hajji', a bank for helping those who want to perform *Hajj* (pilgrimage), was created in Malaysia in 1969. Islamic Development Bank (IDB) came as the first international Islamic bank for helping the Muslim countries in 1975. This is stationed in Jeddah, Kingdom of Saudi Arabia.

The information as published in the Directory of Islamic Banks and Financial Institution, 1997 show that the number of Islamic banks, insurance and financial institutions stood at 294 around the world by 1996. Of these, 245 are in the Muslim countries and the rest 49 are in non-Muslim countries. Among the Muslim countries, the

highest number is seen in Pakistan (59), followed by Sudan (31) and Indonesia (24); whilst in the non-Muslim countries, the highest number appeared in the United Kingdom (11), followed by Switzerland (8) and Bahama (7). The USA has also 6 Islamic financial institutions. Up to 1999, the number of Islamic banks in Bangladesh stood at 5 (plus some Islamic branches and windows of the conventional banks).

Among the countries, particularly among the Muslim ones, Pakistan and Iran have gone in for total Islamisation of their banking systems. Some experiences of these countries are presented below.[1]

(a) Experiences of Pakistan

The 'Objective Resolution' passed by the Constituent Assembly in 1949, which ultimately formed part of the First Constitution of Pakistan (1956), categorically stated that *Riba* should be abolished from the economy as early as possible. But this received no attention of any government until in 1977 when the government asked the Council of Islamic Ideology to prepare a blue-print on the elimination of *Riba* from the economy. The blue-print prepared with the assistance of a Panel of Economists and Bankers was finally approved by the Government of Pakistan in 1980. For implementing the recommendations, the following steps appeared to have been taken in Pakistan.

(i) Ad-hoc measures

In order to eliminate *Riba* from the economy some ad-hoc measures were taken during the period from 1979-80 to 1984-85.

Firstly, interest was eliminated from the operations of the National Investment (Unit) Trust and Mutual Funds of the Investment Corporation of Pakistan. At the same time the House Building Finance Corporation was reorganised according to the principles of the

[1] These experiences are taken from Manzoor Ali (1992, pp.351-356).

Shariah. The HBFC was allowed to have rent-sharing arrangements with builders of the houses.

Secondly, a new financial instrument named 'Participation Term Certificate' (PTC) was created in June 1980. This is based on profit-sharing principle and replaced debenture financing.

Thirdly, in the same year (1980) a new law called '*Mudaraba* Companies and *Mudaraba* (Floatation and Control) Ordinance' was promulgated. According to this Ordinance, *Mudaraba* Certificates are offered for purchase to the public. The money so mobilised is invested in industrial, commercial and other types of enterprises on the basis of modes compatible to Islamic principles. However, because of some complexities, the progress in this case was not very satisfactory. During the first 8 years of its promulgation, only 8 *Mudaraba* have been established and only 4 *Mudarabas* have been floated. It is interesting to point out that the *Mudaraba* floated by the Grindlays Bank (a foreign bank) was oversubscribed. This certainly indicates the potential for its use not only in Pakistan but also in other countries of the Muslim world. Incidentally, the money so mobilised by the Grindlays Bank is being utilised for lease finance and equity participation.

Fourthly, in 1981, the State Bank of Pakistan (i.e., the central bank of the country) allowed the commercial banks to accept deposits on the basis of profit-and-loss sharing (PLS) principle, side by side with their interest-based operations. In conformity with this declaration, the relevant bank laws were amended. For example, the banks were allowed to invest the PLS deposits for purposes where there is no element of interest. These were invested in financing purchase of essential commodities like wheat, fertiliser, sugar, etc.; these were not to be invested in interest bearing government securities or treasury bills. For financing trade bills, the method applied was generally 'mark-down', and for financing export and import bills, expressed in foreign currencies, the banks were allowed to charge the differential between purchase and sale rates of the currencies concerned.

(ii) Permanent measures

The ad-hoc measures under a parallel system as described above continued until June 1984 when it was announced by the Government of Pakistan that the parallel system in the country would be gradually done away with, and from July 1985 no bank was allowed to accept any fresh deposit on the basis of interest, nor were they allowed to provide any advances on the of basis of interest. The law, however, provided that the outstanding fixed deposits and advances done on the basis of interests would continue until the periods of their maturity. A new banking law called 'The Banking Tribunal Ordinance' was promulgated in December 1984. The Ordinance is designed to protect the banks from any delays or defaults following the change-over to The *Shariah* principles.

The State Bank of Pakistan has specified a number of modes of finance for commercial banks operating in the country. These modes are grouped into three categories. The first category is called 'Lending Modes' which includes *Qard Hasan* i.e., loans without interest (or profit) and loans on service charge basis. The second category, named as 'Trade-related Modes', consists of (1) Mark-up, (2) Buy-back agreement, (3) Leasing, (4) Hire-purchase and (5) Development surcharge. 'Investment-type Modes', the third category, includes (1) *Musharaka*, (2) Equity participation and purchase of shares, (3) purchase of PTC and *Mudaraba* certificates, and (4) rent-sharing. However, there is no compulsion on the part of the general banks to follow any particular mode or group of modes. Banks have been given complete freedom to use any mode or modes according to their convenience. The actual picture as can be found in the literature is that the banks' financing operations have been based almost entirely on one method i.e., Mark-up (or *Murabaha* type mode).

The State Bank of Pakistan has switched over from providing finance to banks and other institutions on the basis of profit-and-loss sharing. The monetary instruments of the central bank such as prescription of credit ceilings and mandatory credit targets, variation in cash reserve requirement and liquidity ratio requirement, etc., have remained unaffected.

(iii) The remaining

The process of Islamisation of the banking and the monetary systems is not complete yet. Government sector and foreign sector are still outside the scope of the change-over. Government is still borrowing from the banking system against the issue of Treasury Bills, etc., as well as floatation of short-term and long-term loans. Unfortunately, the banks are again allowed to invest the PLS deposits in the interest-bearing government securities. Notably, in December 1991, the Federal *Shariah* Court in one of its judgements held that the system of mark-up financing as being practised by banks is not in conformity with the injunctions of Islam. It also took exceptions to a number of other practices prevailing in the banking sector. (M. Iqbal 1997, p. 23).[2] More disturbing is the following remark made by Shahid Siddique with reference to the operation of the Islamic banks in Pakistan:

> 'It is also important to keep in mind that Islam has prohibited interest as it amounts to injustice and exploitation. The Quran says, **'And give up what remains of your demand for *riba*' (2:278)** and verse **(2:279)** says, **'Deal not unjustly and you shall not be dealt with unjustly'**. It is therefore obvious that present unjust system which is becoming more and more exploitative can not be termed as Islamic banking' (Shahid Siddique 1997, p. 9)[3].

(b) Experiences of Iran

Although late, the process of Islamisation of the banking system in Iran is more comprehensive and quicker than Pakistan. This is briefly discussed below.

(i) Promulgation of law

The first step taken in the direction of the abolition of interest only resulted in a reduction in the rate of interest and a change of

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[2] See for details M. Iqbal 1997.

[3] Incidentally Shahid Siddique (Director General, Institute of Banking and Insurance) in his above noted study vehemently criticised the Islamic Banks of Pakistan by saying that the Islamic banks have become more exploitative than the previous conventional banks (p.8)

nomenclature to a 'maximum service charge' of 4% and a 'guaranteed minimum profit' of 4 to 8% depending on the type of economic activity. This process of Islamisation of the banks actually started with the passage of a law called the 'Law on Usury-Free Banking' in 1983. This law was made immediately effective. According to this law, all banks were required to convert their deposits from interest-based to PLS-based within one year of their operations and within 3 years of the date of promulgation of the law. Two types of deposits are now allowed namely, (1) *Qard Hasan* Deposits and (2) Term Investment Deposits.

(ii) Provision of incentives

In order to mobilise funds under the new arrangements, the depositors are given some innovative incentives. The *Qard Hasan* accounts are nothing but current accounts which share neither profit nor loss. To encourage the depositors, the banks provide incentives in the form of bonus (without fixing the amount beforehand), prizes, concessional or free of charge services, and preference in regard to provision of finance. For the Term depositors, the banks guarantee the principal amounts and allow the depositors to get them insured. This is perhaps an ad-hoc arrangement.

(iii) Modes of financing

In Iran several modes of financing are allowed. These include (1) *Musharaka* (partnership, used for long-term financing), (2) *Mudaraba* (joint-venture, used for short-term trade financing, not allowed for import financing by the private sector), (3) Direct investment, subject to some safeguards (e.g., initial capital provided by the banks should not be less than 40%), (4) *Bai-Salam* (locally called '*Salaf*'), (5) Instalment sale, and (6) Leasing. In addition to these popular modes, the banks in Iran also provide finance on the basis of what is called *Jualah* (or commission for working as agent) and *Muzarah* (or financing of agricultural production on PLS basis).

(iv) Functions of The Central Bank

Under the changed situations, the central bank of Iran (known as 'Bank Markazi') is required to determine:

- the legal reserve requirements for bank deposits;
- bank-by-bank credit ceilings;
- minimum and maximum expected rates of return from various facilities given to the banks;
- minimum and maximum profit shares for banks in their *Mudaraba* and *Musharaka* financing;
- maximum rates of commission which the banks may charge for investment accounts for which they serve as trustees;
- minimum ratio of liquid assets for short term liabilities;
- maximum amount of credit facilities granted by banks to any single client;
- the ratio of credit facilities granted by each bank to the bank's capital; and
- the maximum amount of commitment made by each bank emanating from opening letters of credit, endorsements, etc.

The central bank is also authorised to audit and inspect bank accounts and documents and make additional rules and regulations, as and when required.

(v) Experiences gained

The available data show that the new system has had favourable impact on the economy. In the very first year of its operation (1984-85), new *Qard Hasan* deposits stood at Riyals 780 billions which gradually increased to Riyals 8,693 billions in 1997-98 (11 times increase in 13 years), that of short-term deposits at Riyals 914 billion which gradually increased to Riyals 24,290 billions in 1997-98 (27 times increase) and long term deposits at Riyals 627 billions which increased to Riyals 22,814 billions (36 times increase) in the same period. As regards modes of financing, the comparative data for the period 1984-85 to 1997-98 show that, in 1984-85, the

share of *Mudaraba* in the total was 18.5%, direct investment 0.6%, civil partnership 15% and instalment sale 34%, in 1997-98 these responses changed to 6.4%, 2.5%, 11.7% and 56%. The changes in instalment sale and *Mudaraba* are noticeable.

It is of importance to note that *Qard Hasan* advance accounted for 10.8% of the total financing. Among others, this finding show that Iran has made a very encouraging start in so far as the application of the investment modes such as *Mushraka* and *Mudaraba* are concerned. However, the data for the period 1984-85 to 1989-90 show that the share of *Mudaraba* in total bank financing has gone down to 10.7 per cent, the combined share of 'civil partnership' and 'legal partnership' has remained unchanged at 18 per cent over this period. The share of 'instalment sales', on the other hand, has gone up from 34% to 56% during the same period.[4]

(vi) Concluding remark

The recent experiences of Iran are not very encouraging. There are studies which have pointed out that no attempt has been made so far to Islamise the international banking and financial operations. Government continues to borrow from the banks at the fixed rate of interest. It has also been pointed out that some banking practices in Iran are a variance from the practice of Islamic banking in other countries

2. ISLAMIC DEVELOPMENT BANK[5]

(a) Basic Features

(i) Establishment

The Islamic Development Bank (IDB) is an international financial institution established in pursuance of Intent issued by a

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[4] For details see Iqbal 1997, pp. 25ff.

[5] All information contained in this section are collected from the Islamic Development Bank **Annual Reports** (various issues).

Conference of Finance Ministers of Muslim Countries in Zul Qadah 1393H corresponding to December 1973, in Jeddah, Kingdom of Saudi Arabia. It started functioning from 15 Shawal 1395H corresponding to 20 October 1975. Its Head Office is in Jeddah.

(ii) Purpose

The purpose of the bank is to foster the economic development and social progress of member countries and Muslim communities of non-member countries individually as well as jointly in accordance with the principles of Islamic *Shariah*.

(iii) Functions

The basic functions of the IDB may be stated thus:

- To participate in equity capital and grant loans for productive projects and enterprises;
- To provide financial assistance to member countries in other forms for economic and social development;
- To establish and operate special funds for specific purposes including a fund for assistantship for Muslim communities in non-member countries;
- To set up trust funds;
- To accept deposits and to mobilise financial resources by way of appropriate modes of financing;
- To assist in the promotion of foreign trade, especially in capital goods, among member countries;
- To provide technical assistance to member countries; and
- To extend training facilities for personnel engaged in development activities in Muslim countries in accordance with the *Shariah*.

(iv) Membership

There are two conditions for membership i.e., (1) the prospective member country should be a member of the Organisation of Islamic Conference (OIC), and (2) it should be willing to accept such terms and conditions as may be decided upon by the Board of Governors. However, the total number of members as in 1415H stood at 48.

The authorised capital of the bank as in 1415H stood at 6 billion Islamic Dinar (ID). The ID is the accounting unit of the bank and is equivalent to one SDR (Special Drawing Right) of the IMF (International Monetary Fund). One ID = Tk 67 approximately. The financial year is the *Hijra* (lunar) year.

(b) Operations: A Review

This section is devoted to a review of the operations of the IDB with reference to the nature and extent of finance, modes of finance and sector-wise distribution. Its operations in the Least Developed Muslim Countries and Special Assistance to Muslim Communities in non-Member Countries are dealt with in separate sections. It is concluded with some suggestive measures.

(i) Nature and extent of finance

The IDB has so far provided finance to its member countries (and to Muslim communities of the non-member countries) in the forms of what are called 'Ordinary Operations', 'Trade Financing Operations' and 'Special Assistance Operations'. During the period between 1396H and 1410H total amount disbursed was ID7, 614m which increased to ID11,138m up to the period 1415H, i.e., an increase of 46% over a period of 4 years. Of the total amount (up to 1415H), 24.7%, 72.0% and 3.2% have gone to Ordinary, Trade and Special Assistance operations, respectively. In terms of the number of operations, it is found that on the whole there were 667 Ordinary, 939 Trade financing and 339 Special Assistance operations, total being 1945. Average rate of finance per operation is estimated at ID5.7m. In 1415H aggregate approvals for the 3 types of operations was ID911.49m (US$1301.28m) which represents an increase of about 23% compared to the aggregate level of approvals in the previous year (1414H).

(ii) Modes of finance

By definition, IDB cannot deal with interest (*Riba*). Instead, it has to provide finance by following only those modes which are

compatible in accordance with the Islamic principles. Financing instruments made use by the bank include loan, equity, leasing, instalment sales, combined lines of finance and profit sharing for ordinary operations. During the entire period under reference, the bank provided ID2,756m (US$3,934.58m) for various Ordinary operations. These were divided into 216 loans, 72 equity participations, 71 leasing, 73 instalment sales, 32 combined lines of finances, 4 profit sharing and 199 technical assistance (total being 667 as noted above). Major allocation by modes of finance are reviewed below.

Loan financing: The loans are provided by definition free of interest. The IDB, however, charges a service fee to cover part of its actual administrative expenses, ranging from maximum of 2.5% for Ordinary loans to 0.75% for loans financed from the Special Account of the Least Developed Member Countries (LDMCs). The repayment period for loans vary from 15 to 25 years for Ordinary loans and from 25 to 30 years (including a 10 year grace period) for loans financed from the Special Accounts. This mode of finance is intended mainly for the construction and development of infrastructure projects of the LDMCs and cover such projects as roads, ports, airports, irrigation schemes, land development, schools, hospitals, etc.

On the aggregate (during the period 1396H - 1415H), 35.4% of total finance under Ordinary operations was devoted to this mode, the trend, however, being on the decline. In 1415H, the IDB approved financing for 16 projects through loans amounting to ID57.52m (US$80m) in 14 member countries. This amount represents only 66% of the previous year's figure. This decline, as noted in the IDB Report, was primarily due to the increase in the number of LDMCs which have arrears in repayment to the Bank. It is, however, estimated that of the total loans advanced, 64% has gone to the LDMCs when loans from the Special Accounts is also considered.

Equity finance: This is a very important Islamic mode of financing. In this mode investment is made through participation in equity capital. This mode accounts for about 8% of the total funds used

under Ordinary operations up to 1415H. This low percentage is actually due to the restriction imposed by the Islamic Fiqh Academy to make equity participation with companies which do not carry interest-based finance on their books. The IDB is, however, known to have exploring some innovative schemes for promoting equity financing in Islamic lines.

Lease finance : Lease financing is one of the most important modes of financing in the Islamic world. It involves the purchase and subsequent transfer to the beneficiary of the right of usage of equipment and capital goods (including ocean-going vessels) for a specified time period, during which the Bank retains ownership of the asset. Funds are made available through this mode for a period ranging from 7 to 15 years, including 2-4 years grace period. This mode provides an assured source of income for the bank. In 1415H, lease financing accounts for ID73.92m (US$ 246.96m) an increase over 91% compared to the amount approved in 1414H. In terms of percentage of the total finance under Ordinary operation, it was 25 for the whole period (1396H - 1415H) showing a continuously increasing trend.

Lines of finance extended to NDFIs: The IDB extends assistance to NDFIs (National Development Financial Institutions) in order to assist small and medium type industrial projects. This is used for financing the private sector. Presently lines are utilised through leasing and instalment sale modes of finance. Since inception, the bank has provided finance to the tune of ID198.37m (US$239.42m) which accounts for over 7% of the total finance in the Ordinary operations.

Technical assistance: This is the mode which is used by the bank in order to provide technical assistance to the member countries. This assistance provided through a number of mechanics, the most important of which is the Technical Co-operation Program Loans and/or grants, are for the identification, preparation and implementation of the projects. Priority is given to LDMCs as well as regional projects. In aggregate, about ID70m was utilised in this type of financing. This represents 2.5% of the total finance under the Ordinary operation.

(iii) Sector-wise distribution

Sector-wise distribution of funds is of crucial importance at least for two basic reasons. One, most of the Muslim countries are basically rural in nature and more than three-fourths of their total population live in rural areas. This implies that the bank should consider this rural sector as a priority sector for funding. Second, the bank is committed to uphold the Islamic principles which implies that the social sector cannot be neglected at all. With this brief background, let us now examine the sector-wise finance of the IDB during the period under reference.

The Annual Reports of the IDB gives the distribution of project financing and technical assistance according sectors. As many as six sectors are distinguished namely, (1) Agriculture and agro-industry, (2) Industry and mining, (3) Transport and communication, (4) Public utilities, (5) Social sectors, and (6) Others (which mainly includes the bank's assistance to the Islamic banks).

It is found that the largest allocation of approved Project Financing and Technical Assistance for the period 1396H-1415H was for the development of infrastructure accounting for about 39% (17.3+21.4) of the total approvals. Of this amount, 21.4% was approved for public utilities and 17.3% was earmarked for transport related activities. It is of importance to point out that the allocation to public utilities has very sharply increased in the recent years. Whereas in 1411H only 18% of the total fund was devoted to this sector, in 1415H this proportion shoot up to 39%.

In order of priority next comes the industry and mining sector which accounts for nearly one-quarter of the total funds during the whole period, the proportion is on the decline; in 1415H it was only 20%.

Given the information, the allocation of funds to the agriculture and agro-industry is not satisfactory. Although on the whole, this sector got 18% of the total funds, its trend is on the decline. It was only 16% in 1415H. This relatively poor result is said to be due to the poor absorptive capacity of the agriculture-based Muslim countries and the difficulties faced in designing and preparing agricultural projects in those countries.

Allocation made to the social sector is not discouraging. It accounts for 15% of the total funds allocated over the entire period, the proportion is, however, is on the increase. This fund is being utilised for human resource development primarily through the financing of health and education operations.

(c) Operations in the LDMCs

One of the important criteria for evaluating the bank's performance is its role in the socio-economic development of its relatively poor member countries. Using the UN classification, the IDB has identified 20 countries (including Senegal) as 'least developed'. These countries are: Afghanistan, Bangladesh, Benin, Burkina Faso, Chad, Comoros, Djibouti, The Gambia, Guinea, Guinea-Bissau, Maldives, Mali, Mauritania, Niger, Senegal, Sierra Leone, Somalia, Sudan, Uganda and Yemen.

It is to be seen how much of the total funds of the IDB are allocated to these member countries through various modes. Incidentally, the least developed countries (as mentioned above) roughly cover a little less than one-third of the total population of all the member countries.

At the outset, it should be pointed out that the IDB maintains a Special Account for the LDMCs whose fund is entirely devoted to the development of the LDMCs. From the records of the IDB, it is seen that during the period under reference, from this account a sum of ID15.04m (US$20.02m) has been allocated to the LDMCs which covers less than 1% of the total funds.

It is also seen that over the entire period out of ID 2,163.50m, 21% has been allocated to the poor countries. If the population becomes an index of evaluation this allocation should be regarded as unsatisfactory: the proportion of funds is much less than that of population. It is found that the major allocation was in the form of import trade financing ID1255m) in which the LDMCs received only 17%. Next biggest allocation has gone to project financing (ID732.40m) from which the LDMCs received less than the proportion of the population they contained. According to the IDB's

assessment, this relatively poor allocation is due mainly to the growing arrears of the beneficiary countries.

(d) Special Assistance for Muslim Communities in the Non-member Countries

The IDB now provides special assistance for Muslim communities in non-member countries, particularly in India. In 1415H, an amount of ID1.25m (US$1.82m) was approved for 11 operations in India, one in Jammu and Kashmir, total amount so far approved reached ID365.75m to this account. The fund is made available both as grant and as *Qard Hasan* for supporting mainly vocational training and educational activities. The bank also provides scholarships for the needy and meritorious students of the non-member countries to pursue undergraduate studies in medicine, engineering, dentistry, pharmacy, nursing, and others.

(e) Some Suggestive Measures

Undoubtedly, the IDB has been playing a very important role in fostering economic development and social progress of its member countries and Muslim communities of non-member countries. However, for future expansion, some comments and suggestions are given below.

- Regarding loan operations, two suggestions can be given. First, as this type of loan does not yield any income to the bank, its amount should be restricted and more attention should be given to lease and equity financing. Second, the IDB may consider whether the *Qard Hasan* can be given to the poor countries. In this case, it would be advisable to reduce the repayment period so that it becomes possible to increase the frequency of recycling the fund.
- To make equity participation more popular, it will be necessary to find out or to create companies or institution which would avoid interest in their accounts for capital used in conjunction with the Islamic banks. It is also suggested that the guidelines made by the bank become simple and implementable in the real situations of the Muslim world.

• Lease financing is expanding quite rapidly. This is definitely encouraging in so far as the income of the bank is concerned. But in this case, the bank should be careful to ensure that no *Riba* element may crop up in its dealings.

• In the list of modes of financing, the position of the PLS system has been found to be very poor. There is considerable scope for the identification of joint venture projects in the member countries. The issues involved in the use of profit sharing should be more carefully reviewed and appropriate guidelines will have to be prepared so that this mode can suitably be used in the future.

• The combined lines of financing mode appears to be useful because through this mode, it becomes possible to finance small and medium sized projects which are so vital for the socio-economic development of the Muslim countries. To make this mode more effective, it is suggested that the cumbersome nature of the Bank's procedures be simplified. As part of its strategy to promote utilisation of the lines, the IDB should continue to strengthen its training programmes which is made to familiarise the staff of the relevant NDFIs. Training materials should be provided to all the relevant institutions so that the mode can be utilised for the interest of both the partners.

• It appears that the IDB has clearly recognised the age-old vicious cycle of poverty of the poor countries. 'The poor countries are poor because they are poor' and have poor absorptive capacity. This vicious cycle must be broken and it is also an important demand of the Islamic *Shariah*. What is needed is the intensive research for the identification of agricultural and agro-industrial projects of the LDMCs and make them available the needed amount of financial support for their development. It is through this action that the concentration of wealth among the riches can be avoided.

• It may be mentioned here that the IDB wanted to start a Micro Credit Programme on a pilot basis for a period of three years in the first instance. The IDB Mission which visited Bangladesh recently would work out the financial plans the terms, conditions and possible

mode of intervention by IDB in the micro-enterprise sector in Bangladesh in the near future. This is indeed a right move in right direction.[6]

3. ISLAMIC BANKS IN BANGLADESH[7]

The preparation for establishing Islamic banks in Bangladesh was actually started in 1978 when Bangladesh participated in the Islamic Foreign Ministers' Conference, held in Dakar, Senegal. The first bank in the private sector came into existence in 1983. This is named as Islami Bank Bangladesh Limited (IBBL). After 3 years, Al-Baraka Bank Bangladesh Limited was created. In 1995, another two Islamic banks came into being i.e., Al-Arafa Islami Bank Limited (AIBL) and Social Investment Bank Limited (SIBL). In the same year, one conventional bank (Prime Bank Limited) opened two branches and another conventional bank (Dhaka Bank Limited) opened a counter to operate on the principles of Islamic banking. In addition, in 1997, a foreign Islamic bank started operating in Bangladesh.

Therefore, in Bangladesh, altogether we have now 5 full-fledged Islamic banks up to 1998. For obvious reason, we have chosen the oldest bank, the Islami Bank Bangladesh Limited, for the purpose of the in-depth investigation. The other banks are, however, referred to as and when they become relevant.

The IBBL (as well as other Islamic banks), as noted above, is in the private sector. The number of conventional private sector banks in Bangladesh is about a dozen. For the purpose of the comparative study, we have chosen two private sector banks i. e., Arab-Bangladesh Bank Limited (ABBL) and Pubali Bank Limited (PBL), the latter was formerly a government sector bank. It may be noted that the choice of these banks, although quite scientific, was largely determined by the access of the author to the required information.

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[6] Mannan 1998, p.10.

[7] This section is drawn from the author's Conference Paper presented at the International Conference organised by the IIUM and IRTI, Malaysia. held during 24-26 April 1999.

The data used in the study were mainly collected from secondary sources. These include Bangladesh Bank Bulletins, Annual Reports of the selected banks and other published documents. The collected data refer to the period 1984 to 1997, although in some cases a shorter time period has to be considered. In order to fill in the information gap and to verify some of the secondary information, some primary data have also been collected. Using a non-structured questionnaire, these were obtained from the practitioners, particularly the bank officials including the chief executives, and some of the clients attached to these banks.

(a) Evaluation of Performance of Islamic Banks

As stated above, of the five full-fledged Islamic banks working in Bangladesh, the IBBL has been selected for evaluation. Before we go on to see its performance, it should be borne in mind that the bank had to start operating under very odd circumstances and under heavy administrative difficulties. The bank is still passing hard days (from the point of view of Islamic *Shariah)* to work smoothly. These points would help the reader to realise the realities under which the bank is operating. Another point to be noted is that the criteria for evaluation have been constrained by the availability of the relevant data.

We begin with some basic statistics of this selected bank. The IBBL has a Board of Directors consisting of 23 members, 14 local and 9 foreign, assisted by a high-powered Committee of 7 members. The Board is responsible for the overall operation and management of the bank. There is a *Shariah* Board consisting of *Ulema,* Islamic economists, lawyers and prominent bankers. This Board looks after the details of the *Shariah* implications of the activities undertaken by the bank. In Table 1 (given at the end of the chapter) are given some vital statistics of the bank. It is seen that it, in 1984, it had only 7 branches. Thereafter, the number of branches increased at a very rapid speed to 21 in only 3 years time in 1987. By 1997 the number stood at100 (in June 1998, the number was 105).[8] During the period from

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[8] It may be noted that total number of branches of all the Islamic banks of Bangladesh constitute only 2.84% of the total branches of all the banks. The information relates to June 1998.

1984 to 1997, the amount of total income increased from Tk 45m to Tk 1369m and total expenditure from Tk 37m to Tk 1198m leaving gross profit of Tk 8m in 1984 and Tk 171m in 1997. The reader can see the other details from the table referred to here.

We now pass on to examine the performance of the IBBL with reference to the points as mentioned in section (c) of the previous chapter.

IDEOLOGICAL CRITERIA

(i) Elimination of *Riba*

This can be ascertained by looking at the modes used by the bank while mobilising deposits and allocating the collected funds. What in Islamic bank one is looking for is an 'Islamic alternative' to the conventional interest-based banking. In effect, the challenge to find out the Islamic alternative provides the rationale of Islamic banking. The most effective alternative is the principle of participation in profit and losses. (Siddiqi 1983, pp. 163-67; Khan and Mirakhor 1989, pp. 57-64). This also means that a fixed rate of interest is replaced by a variable rate of return based on real economic activities (Mangla and Uppal 1990, pp. 179-215). There are at least two modes, which strictly conform to these features. These are *Musharaka* and *Mudaraba.* An Islamic bank can employ some other modes, which are basically trade-related. Some of the *Shariah* permitted trade-related modes are: (a) *Bai-Muajjal,* (b) *Bai-Murabaha*, (c) *Bai-Salam*,

It should clearly be understood that although the trade-related modes are permitted by the *Shariah,* they do not strictly conform to the basic features of an Islamic bank defined in the sense of profit-and-loss sharing. The most fundamental characteristic of these trade-related modes is that their **returns are not variable but are prefixed, they do not depend upon the results of the business.** This does not mean, however, that these modes and 'interest' are equivalent. First, unlike interest, they are fixed on the basis of mutual consultation between the bank and the clients concerned. Second, they do not

involve the cash finance, but rather involves buying and selling of goods and services. In spite of these differences, the Council of Islamic Ideology of Pakistan warns the users not to use the trade-related modes indiscriminately. For example, regarding the *Bai-Muajjal*, the Council opines that 'it would not be advisable to use it widely or indiscriminately in view of the dangers attached to it of opening a backdoor for dealing on the basis of interest'. (Report of Islamic Ideology 1980). Siddiqi (1983a, p. 139) goes on to the extent of suggesting that 'I would prefer that *Bai-Muajjal* be removed from the list of permissible methods altogether'. In one of the conferences held in Bangladesh,[9] Anas Zarqa compared the use of *Bai-Murabaha* type method with salt. He said that a little and necessary amount of salt is OK, but if one uses more than the maximum necessary, the food becomes spoiled. It may be added that the mode like *Qard Hasan* is actually not an investment mode, it can at best be regarded as a benevolent loan given to (mostly) the needy and the distressed persons.[10]

Against these observations the performance of the IBBL can now be evaluated with reference to its modes used while accumulating and allocating funds.

Types of modes used while accumulating funds: As in 1997, paid-up capital and reserve funds represent about 8 per cent of the total deposits (see Table 1). Paid-up capital consists of share-money, which conforms to the nature of *Musharaka* principle. Mobilisation of deposits is accomplished through the application of *Al-Wadia* and *Mudaraba* principles. Of the total deposits, in 1997, *Mudaraba* fund constitutes 85 per cent and the share of *Al-Wadia* deposits is 15%. Apart from *Mudaraba* accounts of various terms (varying from 6 months to 3 years), the IBBL also maintains special accounts such as *Mudaraba Hajj* Savings Account and *Mudaraba*

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[9] Held during 11-13 August 1996 (in which the author was one of discussants).
[10] For a good description of different modes of Islamic finance, see Sharif Hussain (1996).

(i) Mobilisation of savings

Mobilisation of savings is the first and foremost duty of any bank, including the Islamic one we are dealing with. The contribution of the IBBL in mobilising deposit appears in Table-3.

In the second year (1984), amount of total deposit was Tk 636 m, and this continuously increased to Tk 16,557m in 1997, an increase of 26 times over a period of 13 years. Growth rates have been calculated employing the trend equation as:

$$Y = ae^{bt}$$

Where Y is the relevant variable, t is time, a and b are constants, and e is exponential. Here b is interpreted as growth rate for the Y. This relation has been estimated by the OLS technique. The estimated results are given in the last row of the table referred to here. From this, it is seen that total deposit increased at the rate of 21.98% over the period 1984 to 1997. When expressed in terms of deposit per employee and deposit per branch of the bank, the rates become, respectively, 10.95 and 4.29. Total deposits, deposits per branch and deposits per employee are exhibited in Graph 1. It is seen that although total deposits continuously increased during the time period under review, the deposit per branch showed first an increasing trend up to 1987, it showed a declining trend thereafter, and showed an increasing trend again and that continued up to the last year.

On the whole, these results do demonstrate the strength of the IBBL. It should, however, be borne in mind that all Islamic banks together constitute only 5.27% of the total deposits mobilised by the banking sector in Bangladesh as in June 1998.[11]

(ii) Utilisation of funds

Mere mobilisation of funds is of no use to a bank, it will have to be used in the productive activities. In the language of Islamic banks, it will have to be invested. The IBBL, like any other bank in Bangladesh, is not allowed to invest the entire amount of its funds: it is under obligation to keep 10 per cent of its total funds as statutory

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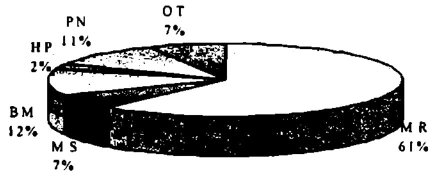
[11] Source: Bangladesh Bank.

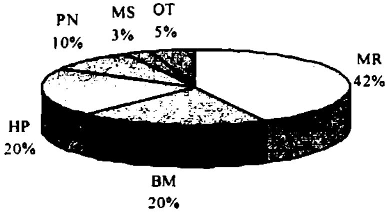
liquidity reserve with the central bank (i.e., Bangladesh Bank). This means that the IBBL can invest up to 90 per cent of its total deposits. We now examine the trends in investment of the IBBL.

Pie Chart-1
Distribution of Operational Modes
of the IBBL in 1987



Abbreviations (For Charts 1 and 2): MR = *Murabaha*, MS = *Musharaka*, BM = *Bai-Muajjal*, HP = Higher purchase, PN = Purchase and negotiations, and OT = Others.

Pie Chart-2
Distribution of Operational Modes
of the IBBL 1997



In Table 3 are provided the relevant information. It can be seen from the table that total fund employed increased from Tk 458m in 1984 to Tk 13,095m in 1997, an increase of 29 times over the 13 year period. The annual growth rate is estimated at 24.14%. This rate is higher than the deposit mobilisation rate (21.98%). This implies that the bank is making good progress in so far as the utilisation of the mobilised funds is concerned. The growth rates relating to per employee and per branch employed funds were respectively, 7.68% and 13.11%. The rate of utilisation of funds is also praise-worthy. Average rate is calculated as 88.61%. This represents one of the great strengths of the bank. The information on utilisation of funds is also depicted in terms of graphs (see Graph 2). It should, however, be borne in mind that the investments made by all the Islamic banks in Bangladesh constitute only 5.36% of the total investments/ advances made by the banking sector.[12]

(iii) Neglect of the agricultural sector

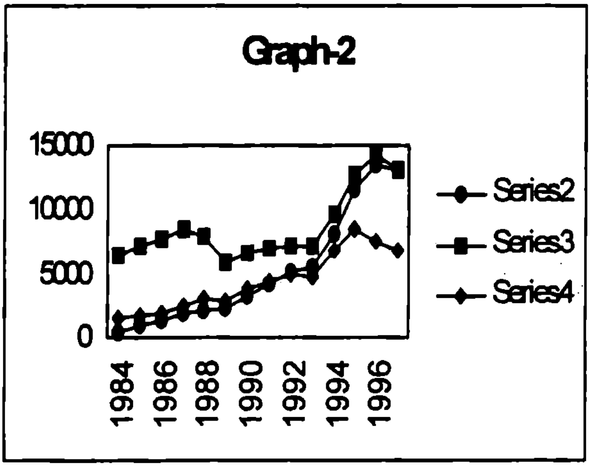
For a predominantly agricultural country like Bangladesh, the use of funds in the different sectors is very important because this testifies the bank's performance in terms of distributive efficiency. For an Islamic bank like the one under review, this is more important as this will demonstrate the extent to which it has achieved its overall objective, i.e., growth with equity. The data as exhibited in Table 4 shows that the commerce or trade and business sector accounts for the lion-share of the total investment of the IBBL. Its share declined from 71% in 1987 to 37% in 1997. About one-third of the funds is utilised in the industrial sector. The declining share of the commerce sector appears to have been compensated by the increase in the share of the industry sector. In 1997, about 43% of the total allocated funds was devoted for this sector. These allocations of funds are in sharp contrast with that of the agricultural sector, which still accounts for one-third of the total national income in Bangladesh. The bank utilises

[12] Ibid.

only a negligible proportion of total funds in agricultural sector. In 1997, allocation to this sector was less than 1%. This pattern of utilisation of funds is not in line with distributive justice as expected from this bank. This is one of the great weaknesses of the bank.

(iv) Mobilisation of human resources

Human resources are now being recognised as an alternative to financial resource needed for economic development. For a Muslim country like Bangladesh, this resource is generally neglected on the grounds that they are poor, illiterate, assetless and, and above all, culturally backward. However, some institutions like the Grameen Bank in Bangladesh have proved beyond doubt that if the poor can be properly organised and are given sincerely and efficiently supervised financial help they can be turned into assets and can contribute substantially towards economic development. However, the Grameen Bank approach to human resource mobilisation is accomplished on the basis of interest. It was expected that the Islamic banks would come forward to undertake this task with Islamic modes of finance. Our experience shows that the role of the Islamic banks in this respect is anything but poor.

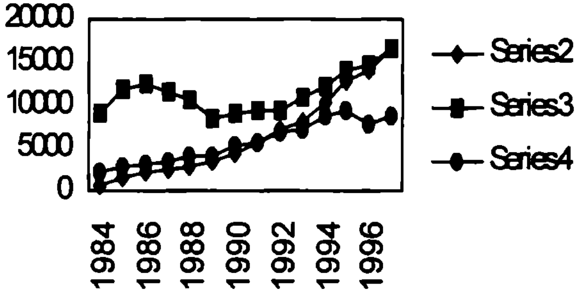


Graph-1: Mobilisation of Deposits of IBBL (1984-1997)

(Series 2 = Total deposits; Series 3= Dep per branch and Series 4 = Dep per employee) (Series 2 = Total employed fund; Series 3 = Employed fund per branch; and Series 4 = Employed fund per employee of the bank).

(N.B.: In the above two graphs, the figures for deposit per branch and per employee and fund employed per branch and per employee are those of Table 3 multiplied by 100).

Graph-1



(v) Mobilisation of non-human resources

Bangladesh has huge non-human resources. No systematic and meaningful attempt has yet been made to identify, develop and manage these resources for economic development. In one of his studies Mannan has shown that in Bangladesh, there are 0.15 million *waqf* properties and out of 0.13 million mosques, 0.12 million are *waqf* properties (Mannan 1995). If these properties along with inheritance properties, joint-venture projects for management of *Hajj* affairs, development and management of non-profit foundations, charitable trusts and organisations, and development and management of funds involving welfare of women and non-Muslim minorities are developed, these can make tremendous contributions to the socio-economic development of the society. The contribution of IBBL is not at all encouraging. It is the SIBL which has made an attempt to develop this sector although we are yet to see its implementation.

(vi) Ensuring *Adl* and *Ihsan* in the society

Unlike conventional commercial banks one of the objectives of the Islamic banks is to ensure *Adl* and *Ihsan* in the society. Several criteria can be used to examine the extent to which the Islamic banks have achieved this special objective. These are: proportion of total profit paid to the depositors, rate of return charged for various activities from the clients, proportion of total deposits collected from the rural areas and the proportion of total allocations made to the rural areas and to the agricultural sector as well. As shown in Table 5, the IBBL pays 3.92% of its total volume of working fund to the depositors which is much less than what is being paid by its counterpart, the ABBL, 6.67%. Since Islamic banks employ *Murabaha* type modes, it charges the same rate of return from all activities. No distinctions are made as to whether the commodities are essential or luxury. The proportion of total deposits collected from the rural area is small, so also the advances. The point to note is that the funds collected from the rural areas are being transferred to the urban areas (see Table 5). Above all, the allocation to the agricultural sector is very negligible. For example, in 1997, only 0.32% of total funds was allocated to this sector by the IBBL.

From all these, one may tend to infer that IBBL (and other Islamic banks) has so far failed to ensure justice and kindness in the society. The IBBL has, however, a welfare programme. Through this programme, it carries out such activities as income-generation, education, health, relief and rehabilitation, etc. These activities are basically social welfare-oriented. From the point of view of Islamic economic development what is needed is social investment that would help the poor and unemployeds stand on their own legs. In 1997, the amount of funds devoted to income generation was very small (Tk 6.71m) which accounts for only 15% of the total funds devoted for the purpose. This can not but be regarded as weakness of the bank.

(vii) Providing the usual banking services

Islamic banks are expected to provide the usual banking services through opening of deposit and investment accounts,

financing trade, providing letters of guarantee, opening letters of credit, collection of bills, effecting domestic and international transfer, and so on. Without any doubt, the Islamic banks in Bangladesh are providing all these usual services at least as efficiently as the age-old conventional banks. Their behavioural services are better. Even the 'unIslamic' people tend to believe that the clients can obtain their finances from the Islamic banks without resorting to any corruption or paying any 'extra' money. The increase in the number of Islamic banks, increase in the number of their branches (22.21%), deposits per branch (4.29%) and investment per branch (7.68%) bear testimony to this assertion. The Islamic bank can demand full credit in this respect.[13] However, as its financing is basically concentrated in trade and commodity financing, it may be said that it does not qualify as a full-fledged substitute for conventional banking.

(viii) Multi-institutional character

In order to achieve the socio-economic goals of Islam, it is required that the Islamic bank takes the character of a multi-institution. This means that it will combine the roles of a commercial, development and welfare-oriented bank. The picture of IBBL that we see now is far from this multi-institutional character. It is basically, at the moment, commercial in nature. Whatever it does mainly involves profit-earning activities. However, it deserves some credit for performing some welfare-oriented activities.

(b) A Comparison of Performances of IBBL and Conventional Banks

METHODOLOGY

This section will make a comparative study between the IBBL and conventional banks. As stated above for comparison we have selected two conventional banks namely, the Arab-Bangladesh Bank

[13] The figures mentioned in this sentence refer to the growth rate of the IBBL for the period 1983-1997, see Table 3.

Ltd (ABBL) and Pubali Bank Limited (PBL). For making the comparison, five criteria have been chosen. These are:

- Profitability,
- Productivity,
- Liquidity,
- Contribution to the national exchequer, and
- Distribution.

These criteria are briefly explained as under.

(i) Profitability

In economics, profit (PR) is defined as the difference between total income (TY) and total expenditure (TE). In commercial banks, there are two sources of income, interest-income (IY) and non-interest income (NIY). Similarly, expenditure is divided into interest-expenditure (IE) and non-interest expenditure (NIE). These can also be shown as:

$$\begin{aligned} PR &= TY - TE \\ &= (IY + NIY) - (IE + NIE) \\ &= (IY - IE) - (NIE - NIY) \\ &= (\text{Spread}) - (\text{Burden}) \end{aligned}$$

That is, profit can also be defined as the difference between 'Spread' (which reflects the difference between interest-income and interest-expenditure) and 'Burden' (which reflects the difference between non-interest expenditure and non-interest income). Incidentally, in the case of an Islamic bank, 'profit-income' and 'profit-expenditure' will replace the term 'interest-income' and 'interest-expenditure', respectively.

For measuring the profitability of the two types of banks, the volume of working fund (VWF) has been employed. For the purpose of the analysis, the VWF is defined as 'the balance sheet total minus contra items. Contra items are those items which do not involve direct raising or lending of funds' by the institution concerned (Alam and

Misir, 1998, p. 47). For this analysis, PR (and its components) has been expressed as the ratio of VWF. 'Profit' refers to net profit before appropriation.

(ii) Productivity

This is generally defined as the ratio of output and input. In the banking industry, loans and investments are assumed as output and financial liabilities (such as capital, labour and land) as inputs. More precisely, gross income and gross expenditure are considered, respectively, as outputs and inputs. For this analysis, the following ratios have been calculated: (i) VWF/ME, (ii) VWF/TE, (iii) TY/ME. and (iv) TY/TE, where ME stands for manpower expenditure. Other variables are as defined as above.

(iii) Liquidity

In a sense, liquidity is the life-blood of a bank. It refers to the ability of the bank to raise a certain amount of fund at a minimum cost within a given period of time. For the purpose in hand, ratio of cash to total deposits and liquid assets to total deposits will be used as the measures for judging the liquidity of a bank.

(iv) Contributions to the National Exchequer

This is another important criterion that can be used for comparing the performances of the two banks under review. It is said that the more a bank contributes to the national exchequer, the better is its performance, *ceteris paribus*. The bank makes this contribution in two forms, tax and dividend. Both these types of contributions are considered while applying this criteria.

(v)Distribution

'Distributive efficiency' is defined as the decision (as well as its execution) of the bank to maintain equity in the matters of distribution of profit (in the case of an Islamic bank) or interest (in the case of conventional bank) between itself and the clients it is associated with. For this, the following tests are used:

- **Profit or interest paid to depositors/VWF:** A high value of this ratio indicates a tendency towards better distribution of incomes generated through the banking process.
- **Rural-Urban Ratio:** The proportion of total deposits collected from rural (urban) areas vis-à-vis the proportion of total advances or investments allocated to the rural (urban) areas.
- **Banking Inequality Index** defined as the ratio of cumulative percentage of total advances and cumulative percentage of total deposits. This banking inequality index implies that the higher the value of the lower limit of the range, the higher the possibility that the banking system is equitable i.e., efficient from the viewpoint of distribution.

ANALYSIS OF THE RESULTS

Calculated results of the above tests are given in Table 5. We now pass on to interpret the results.

For measuring **profitability,** three criteria have been used, profit, spread and burden. All these have been expressed as percentages of the volume of working fund. The figures are yearly averages for the period 1988 to 1995 for IBBL and ABBL and for 1988 to 1993 for PBL. The results show that the spread, the first component of the profit, is the highest for ABBL (1.72%). The position of the IBBL is in the middle (1.14%). The burden, the second component of the profit, is negative (-0.22) for IBBL indicating that non-profit income (i.e., profit earned from sources other than the usual investment) is higher than non-profit expenditure. The overall profit ratio (PR/VWF) is however the highest (1.36) for the IBBL when compared with the two conventional banks (1.03 for ABBL and 'negative' for PBL) under review. This indicates that for each taka of working fund there was a profit of Tk 0.36. It can thus be concluded that from profitability point of view the position of the IBBL is better than the conventional banks. It is a strength.

For measuring **productivity,** four criteria have been used. As numerators, volume of working fund and total income and as denominators, manpower and total expenditures have been used. The results (as shown in Table 5) show that from the viewpoint of overall productivity (i.e. when total income or total expenditure) is considered, the position of IBBL becomes better than those of the conventional banks. However, when the manpower expenditure (manpower productivity) is considered the position of IBBL becomes lower than that of the ABBL. This has happened simply because of the fact that the IBBL at the initial stage could not but hire suitable and experienced bankers from the conventional banks with very high costs. This indicates that there is a scope for lowering the manpower expenses of the IBBL. The IBBL earns Tk 1.23 for each taka of expenditure. This figure is 1.11 for ABBL and 0.90 for PBL. The readers can see the other details from the table referred to here. In any case, the position of IBBL still remains better than that of its other counterpart (PBL).

For examining the **liquidity** position of the banks under review, two criteria have been employed, cash to total deposits and liquid assets (cash balance, money at call and short notice, bill of exchange, and the like) to total deposits. The calculated results show that the position of IBBL is far better than those of the conventional banks. The IBBL has always maintained good liquidity over the whole period of its operation. It may be noted that the commercial banks are normally required to maintain not more than 25% of their deposits in the form of liquid assets. In contrast, the IBBL had maintained on the average 37.66% of its total deposits in the form of liquid assets. This may mean that the bank is suffering from excess liquidity. In a sense this is not bad, because during any emergency, the bank has to stand upon its own leg. Like the conventional banks, it can not easily from borrow the central bank as it involves interest. It is a strength.

For showing the **contribution to the national exchequer**, we ask two questions: one, how much is contributed by the bank both in terms of taxes and in terms of dividend; and two, what that stands for

in terms of volume of working funds? The results as presented in the table gives that during the period between 1988 and 1995, the contribution of IBBL was higher (on an average Tk 64 million per year) that that of its counterpart (Tk 57million). These contributions, respectively, account for 0.71% and 0.69% of the total volume of working fund of these banks. This higher contribution of the IBBL definitely reflects its better performance when compared with the conventional banks. This gives one of the strong points in favour of the Islamic banks.

For examining the performances of the IBBL vis-a-vis conventional banks from the point of view of **distribution,** three criteria have been employed. Profit or interest paid to depositors indicate a poorer performance of the IBBL when compared with the ABBL but better performance when compared with the other interest-based bank. This depression of profits is perhaps due to the fact that the traditional banks can meet up losses arising out of delay in repayment by the clients through charging compound rate of interest, but the IBBL can not. The result is similar when we consider the rural-urban criteria. From the viewpoint of distribution, it is expected that the bank will strive to invest in the rural areas at least the amount equivalent to the amount of deposit made by the rural people. However, the position of the IBBL is better when it is tested from the viewpoint of banking inequality index. One can verify that, as expected, at the lower end of the scale the figures are higher for the IBBL than the conventional banks.

From the above analysis, it can conveniently be concluded that the performance of the Islamic banks is much better than those of the interest-based banks. This finding implies that the Islamic banks in their present forms and style have come to stay and will stay even if no further measures are undertaken in order to remove the bottlenecks.

(c) The Gaps between Theory and Practice

In this section, on the basis of the discussions of sections 3(a) and 3(b) above, the gaps between theory and practice are derived. This is shown in terms of a Chart as under.

Before one goes on to read the chart a few points are to be taken care of. First, the chart is prepared on the basis of the discussion of sections 3(a) and 3(b). Second, the issues are the same as noted in section 3(a). Third, having observed the gaps between expectations and realities, comments are made in the form of 'weakness' or 'strength'. Fourth, a scale is assumed from '0-1' to represent weakness and from'2-3' to represent strength. The marks assigned against each criterion, although arbitrary, represents the author's experiences gained in course of interviews conducted for the purpose of the study. Intention here is to see the qualitative position of the Islamic banks in Bangladesh.

Thus, given the analysis, the performance of the IBBL, both singly and in comparison with conventional banks, can safely be regarded as above average.

(d) Factors Responsible for these Gaps

This section is devoted to identify the factors responsible for the gaps between expectations and realities as obtained. In order to maintain the sequence, these factors are discussed under the same two broad heads, ideological and economic.

(i) From ideological viewpoint

From the viewpoint of Islamic ideology, the basic issues relate to the choice of investment modes and the choice of activities. From the point of view of investment modes it may be remembered that from an Islamic perspective, the best modes of investment are PLS modes, that is, *Mudaraba* and *Musharaka.* Our analysis has shown that these modes are not being applied to the extent desired. In Bangladesh only 2 to 4% of the funds are being allocated through the *Musharaka. Mudaraba* has not got any place whatsoever. It is possible to identify a number of reasons behind the poor show of the *Musharaka* and *Mudaraba* techniques.

Chart 1
The Gaps between Theory and Practice of Islamic Banks and Conventional Banks

Issues	Theory	Practice	Comments (Weakness or Strength)
1. From ideological viewpoint			
a. *Riba*			
While accumulating funds	Eliminate completely	Eliminated substantially	Strength : 2
While allocating funds	Apply basically PLS modes	Applied basically trade-related modes	Weakness : 1
b. Nature of activities	Only those which are permissible under *Shariah*	Followed, although not very strictly	Strength : 2
2. From Islamic economic development viewpoint			
(i) Performance of Islamic banks			
a. Mobilisation of savings	Increase at a reasonable rate	Increased at a reasonable rate	Strength : 3
b. Utilisation of funds	Make proper utilisation	On the whole good	Strength : 3
c. Sector-wise investment	Not to neglect the agricultural sector	Clearly neglected	Weakness : 0
d. Human resources	Help mobilise unemployed resources	Contribution not satisfactory	Weakness : 1
e. Non-human resources	Help mobilise non-human resources	Contribution not satisfactory	Weakness : 1
f. *Adl* and *Ihsn*	Ensure *Adle* and *Ihsan*	Ensured to some extent	Weakness : 1
g. Usual banking services	Provide effectively	Provided effectively	Strength : 3
h. Comprehensiveness	Multi-dimensional in character	Same are in theory, not in practice	Weakness : 1
(ii) By Com a. Profitability			
Spread/VWF ratio	Will be higher	Lower	
Burden/VWF ratio	Will be lower	Lower	
Profit/VWF ratio	Will be higher	Higher	Strength : 3
b. Productivity			
VWF/Total exp. ratio	Will be higher	Higher	Strength : 3
VWF/Manpower exp.	Will be higher	Lower	Weakness : 1
Total Income/T. exp.	Will be higher	Higher	Strength : 3
Total income/Man. ex	Will be higher	Lower	Weakness : 1

c. Liquidity			
Cash to deposit ratio	Will be higher	Higher	Strength : 3
Liquid assets/dep. ratio	Will be higher	Higher	Strength : 3
d. Contribution to the national exchequer			
Total contribution	Will be higher	Higher	Strength : 3
As % of VWF	Will be higher	Higher	Strength : 3
e. Distribution			
Profit or interest paid	Will be higher	Lower	Weakness : 1
Rural-urban ratio	Rural sector will not be neglected	Neglected	Weakness : 1
Banking inequality	Better distribution	Comparatively better	Strength : 3

On the basis of the results as exhibited in the above chart, it is now possible to give a summary view.

Criteria	Theory	Practice	Position
Ideological	9 points	5 points	Average +
Economic			
Own performance	24 points	13 points	Average +
By comparison	36 points	28 points	Very good
Overall	69 points	46 points	Average +

First, the entrepreneurs, on the basis of their present knowledge, do not like to take funds through the PLS modes. Notably, this method requires true reporting of the business accounts. Most of them do not have any knowledge about this; those who have some ideas about it do not like it and sometimes they consider it as interference to their conventional business practices. They do not like it for one 'technical' reason too. If they show correct account to the bank, they may be liable to pay a very high rate of taxes. So the PLS modes involve moral hazards. Many of them move freely from the Islamic banks to conventional banks and vice versa with the aim of getting loan, no matter whether they are based on interest or profit.

Secondly, the Islamic banks themselves do not like to get involved in the PLS modes. They consider them risky and laborious too. It is gathered that the pioneer Islamic bankers in the IBBL were trained and had occupied high office in the commercial *Riba*-based

banks they once served. Although we place high respect for their untiring effort and determination to learn the *Shariah,* most of them have not been able to drive away their experiences of the interest-based banking. They find working with the trade-related modes more comfortable. The bank in general suffers from other constraints. There is the lack of *Shariah*-based security market, Islamic insurance, support institutions and above all, sufficiently trained and committed officers. The Islamic banks appear to consider, like their conventional counterparts, profitability, liquidity and safety as criteria of success. This has led the banks to continue using the risk-free techniques and has led them to over-reliance on *Murabaha* mode at the expense of the *Musharaka* and *Mudaraba* techniques.

Thirdly, the Islamic banking system suffers from sufficient number of interest-free financial instruments acceptable both to the entrepreneurs and to the banks. There is also a lack of legal protection. For example, presently, interest-cost on borrowed funds is exempted from taxes whereas dividend paid on funds mobilised as equity is subject to tax at different rates varying up to 50%.

Fourthly, the Islamic banking system in Bangladesh suffers from unified *Shariah* rulings. All the four local Islamic banks have their own *Shariah* Boards but there is no meaningful co-operation and co-ordination among them. This has given rise to confusion among the concerned people. For example, some rulings of the *Shariah* Board of one Islamic bank are being regarded as completely *Haram* by another Islamic bank!

(ii) From Islamic economic development viewpoint

From the viewpoint of Islamic economic development, serious gaps have been identified with respect to comprehensiveness, human and non-human resource mobilisation, manpower expenditure, liquidity, profit paid to depositors, urban-rural distribution and agriculture.

First, perhaps the most serious constraint of the Islamic bank in Bangladesh and in most other Muslim countries is its coexistence

with the interest-based banks. It has to compete with these banks in earning profits, more so, in maximising profit. This is the reason for which the bank can not finance agricultural projects (because these require small financing and at the same time involves greater risk) and gives more emphasis on the ready made garments (which provide them with ready income), rather than small-scale industry. This objective is also forcing the Islamic banks to devote their funds to the short run, quick-yielding projects. Moreover, since the entrepreneurs freely move from Islamic banks to conventional banks, and vice-versa this creates an adverse selection problem for the Islamic banks. Clients with 'below-average' profit expectations prefer PLS system in order to minimise their losses in the likely event of failure while those with the 'above average' profit expectations prefer interest in order to maximise their gains in the likely events of success. Its obvious consequence is that the Islamic banks receive a disproportiorately large amount of the bad risks.

Secondly, the Islamic bank suffers from excess liquidity. This is in a sense both a curse and a blessing. It is a curse in the sense that it does not yield any income. It is a blessing in the sense that, as it can not freely enter in to the money market, this excess liquidity can help meet the emergency need of the bank.

Thirdly, existing default-culture has also become a matter of concern for the Islamic banks. It is gathered that classified loan presently (1998) constitutes about 20% of the total investments of the Islamic banks.[14]

(e) Some Suggestive Measures

To deal with the operational problems of the Islamic banks some suggestions are in order.

(i) From ideological viewpoint

From the ideological point of view what is necessary is to create **Islamic Man** as distinguished from 'Economic Man'. For the

[14] Source : Bangladesh Bank (unpublished).

bank, it is necessary to impart training and re-training for the staff. Quick and short-term training of the personnel drawn from the conventional banks will not serve the purpose. The Islamic banks jointly should come forward to establish 'Research, Development and Training' institution in order to, among others, develop appropriate training modules and Islamic financial instruments. They will have to improve their managerial as well as religious capabilities by training and re-training their personnel in project appraisal, monitoring, evaluation and performance auditing. It is also suggested that Islamic economics curricula be introduced right from the secondary school stage with appropriate design of the syllabus. The subject should be elaborately taught at the college and university levels, so that the banks can recruit knowledgeable personnel right at the entry level.

Secondly, we have seen that the Islamic banks are operating quite successfully side by side with conventional banks. It is high time that the Government comes forward and make appropriate legal framework based on the Islamic *Shariah* so that the Islamic banks can take the necessary measures in realising its time-barred loans, collect (and, if possible, distribute) *Zakat* on behalf of the Government. The Islamic banks can establish '*Zakat* Fund' and actively explore the possibility of utilization of this fund in lawful '*Mudaraba* Project' as a financial partner made for the benefit of the poor. The compromises being made by the Islamic banks in Bangladesh with respect to the *Shariah* laws should not be continued for long. The bank is making compromises in several aspects. For example, due to *Shariah* restriction, it can not charge extra money from those clients who have become unable to repay fully their dues to the bank within the pre-agreed time period. In this case, it is charging extra money at the same rate as the original contract under the name 'compensatory charge' but diverting this money from the profit account to the 'Charity' account. Again, under compulsion sometimes it is borrowing money from interest-based financial intermediaries. The amount of interest charged is being paid from this charity account. In the absence of Islamic insurance, the bank also pays its insurance premium (needed for insuring vehicles leased out) out of the Charity fund. Under the guidance of the Bangladesh Bank, the Islamic banks should

themselves take the initiative to frame appropriate legal framework for the approval of the government.

Thirdly, Islamic insurance, either on the initiative of the Government or on the initiative of private companies, should be established as soon as possible. If any private company comes forward to establish an Islamic Insurance company, the Government should provide all possible support.

Fourthly, profit-based, in place of interest-based, securities should be introduced. A good opportunity already exists to Islamise the Investment Corporation of Bangladesh. The Bangladesh Bank can introduce *Mudaraba Bond* in line with the Government of Malaysia. In this case the rate of profit is suggested to be determined by the growth rate and the rate of inflation. Development of *Shariah*-based money market would help the Islamic banks to get rid of their excess liquidity problem. Under the guidance of the Bangladesh Bank, the Islamic banks should themselves come forward to create inter-Islamic bank money market and frame bye-laws necessary for proper running of the Islamic banks. The inter-Islamic bank money market would certainly help them avoid *Riba*-based transaction of money. It is suggested that the Bangladesh Bank establishes 'Islamic Banking Affairs Division' in order to look after the interest of the Islamic banks.

Fifthly, it is noticed that the clients have a tendency to exaggerate expense and under-declare profits in order to avoid payment of taxes. Due to this the Islamic banks also suffer because they will also have to share lower profits. In order to get rid of this problem, Iqbal suggests that the 'income profit/tax should be replaced by net worth tax or tax based on capital rather than profit' (Iqbal 1997 p. 45). Its practicability may be explored.

Sixthly, the Islamic bank should try to take the responsibility of managing *Hajj* affairs in line with the Tabung Hajji of Malaysia. It should try to develop different financial instruments with different set of rules in conformity with the *Shariah*. These instruments may include Waqf Properties Development Bond, Cash Waqf Deposit Certificate, Mosque Properties Development Bond, *Qard Hasana* Certificate, Hajj Savings Certificate and Non-Muslim Trust Properties Development Bond. The value of all these bonds and Qard Hasana

Certificate are guaranteed by the bank against the surrender of the instrument on maturity. The SIBL is striving to develop and activate some of these instruments. According to Mannan, Cash Waqf Certificate, if implemented, can partially substitute a substantial part of the income tax for financing such social projects as education, health, and social welfare activities. What is needed is a political will. Incidentally, Bangladesh has over 155,000 Waqf Mosque Properties as well as Non-Muslim Trust Properties.[15]

Finally, all the Islamic banks should have only one *Shariah* Board. This would not only help reduce the administrative cost but also help circulate a unified opinion on the *Shariah* related issues. Given the lack of understanding among the Islamic banks, the Bangladesh Bank should come forward to take the lead in this regard.

(ii) From Islamic economic development viewpoint

First, presently the Islamic banks appear to concentrate on deposits and investments mostly on the short-term basis. Although this system may have contributed in the past, to meet the challenge of the 21st century, the bank will have to be prepared to provide long-term investment. It is understood that finance of agriculture has its own problems. Even the Bangladesh Krishi Bank, created to provide loans only to the agriculturists, have failed to deliver the goods in this sector because of its special characteristics and problems. In spite of this problem, since this sector is the dominant sector in the whole economy, Islamic banking will have to come up with new solutions and new modes of financing to deal with the problems in this sector in a creative and innovative manner. It can extract experiences from the Grameen Bank. In any case the Islamic banks will have to diversify its investment portfolio. The bank should go for investment in large-scale dairy farming and other milk processing projects and poultry farming . The quantum of bank's investment against fishing is very negligible. There is scope for investment in shrimp culture, sweet water fishery including pond fishery, etc. It is strongly suggested that the Islamic banks would give due importance to micro-credit.

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[15] For details see Mannan 1998, pp.12-14.

Secondly, a recent study shows that 60% of the total deposits of the formal banking sectors in Bangladesh is invested in Dhaka, 20% in Chittagong and the remaining 20% for the rest of the country (Mannan 1998, p.18). It is also seen that there has been a net transfer of resources from the rural to urban areas over the years aggravating thereby level of poverty in the country. This is clearly against the Islamic norms. Islamic banks must try to correct this regional imbalances.

Thirdly, the bank's export investment is mostly centred around ready made garments and the bank is yet to enter into the area of investment in major traditional and non-traditional exportable items like jute and jute goods, frozen foods, hosiery products, tea and leather and leather products keeping in view the outcome of the Uruguay Round of GATT and free market operation in the international arena.

Fourthly, attempts should be made to get rid of the default-culture from which the Islamic banks are seen to be suffering. This requires a good investment-client development programme in the Islamic banking system.

Finally, we propose to open Islamic counters in the existing commercial banks (as Prime bank has done it). This would open the door for healthy competition among the Islamic banks and improve their efficiency.

(f) Concluding Remarks

Islamic banks have come to stay and have proved to be sustainable beyond doubt. Its better performance when compared with the conventional banks is a testimony to this. The people have now great confidence in the Islamic banking activities. The price quotation of share of IBBL in the stock exchange market was as high as Taka 7,400 in 1995 as against face the value of Taka 1000. However, we emphasise the two challenges that the Islamic banks will have to face in the next century.

The basic challenge for the Islamic banks for the 21st century, from ideological viewpoint, would be **how to Islamise the Islamic banks.** Development of appropriate Islamic instruments acceptable to the *Shariah* and to the practitioners would be the basic course of

action needed. There is no substitute for creating Islamic man for running the Islamic banks. An attempt may be made to establish what Shahid Siddique (1997) calls Islamic Model Bank. This bank will accept deposits only from those persons who want their deposits to be employed only in the PLS activities and would participate with those clients who are committed to this type of activities. If this type of bank can be made a success it may open a new era for the Islamic banking system in the contemporary world.

From the Islamic economic development viewpoint, the challenge for the 21st century would be **how to bring the vast majority of the people who are living below the poverty line within the orbit of the Islamic banking.** Providing supervised financial assistance, without any collateral, to the poor and needy would be the course of action needed.

Let us hope (like Khurshid Ahmad 1997, p. 14) that during the transitional period, the Islamic and conventional banking will not look upon each other necessarily as rivals, despite their differing perspectives and idealisms. If they co-operate, they can become partners in building a brighter future for mankind, both in the Muslim and in the non-Muslim worlds.

REFERENCES FOR FURTHER READING[16]

1. Monjoor Ali (1992a), 2. M. A. Hamid (1999), 3. Badiul Alam and M. N. Islam (1998), 4. Shah Muhammad Habibur Rahman (1996).

[16] For details, see the list of references given at the end of the Book.

Table – 1
Progress of Islami Bank Bangladesh Ltd.
(1984, 1987 and 1997)

(Taka in million)

ITEM	1984	1987	1997
(1) Authorised Capital	500	500	500
(2) Paid-up Capital	71.50	80	318
(3) Reserve Fund	5.60	49	930
(4) Total Income	45	181	1369
(5) Total Expenditure	37.17	174	1198
(6) Profit	8	7	171
(7) Total Manpower (Nos.)	291	720	1903
(8) Branches (Nos.)	7	21	100

Source: ***Annual Reports*** **Islami Bank Bangladesh Limited** (various issues).

Table - 2
Investment Modes of IBBL (1987-97)

(In percentages)

	1987	1991	1993	1995	1997
1. *Murabaha*	61.49	50.04	47.41	53 54	42.51
2. *Musharaka*	6.46	2.30	3.43	3.87	2.62
3. *Bai-Muajjal*	11.86	20.86	20.41	17.28	19.90
4. Hire Purchase	2.42	14.28	13.87	14.57	20.51
5. Purchase and Negotiation	10.78	8.58	10.54	7.18	9.65
6. Others	6,99	3.94	4.34	3.56	4.81
Total (Amount in million Taka)	**100.00 (1,809)**	**100.00 (4,283)**	**100.00 (5,543)**	**100.00 (11,512)**	**100.00 (13,075)**

Source: ***Annual Reports*****, Islami Bank Bangladesh Limited** (various issues)

Table -3
Picture Relating to Deposit Mobilisation Fund Utilisation of the IBBL
(1984 – 1997)

Year	Number of Branches	Employment	Total Deposit	Deposit per Branch	Deposit Per Employee	Total Employed Fund	Employed Fund per Branch	Employed Fund Per Employee	Fund Utilisation Rate
1	2	3	4	5	6	7	8	9	10
1984	07	291	636	90.48	2185	458	65.40	1573	79 99
1985	13	539	1564	120.30	2901	971	72.96	1801	68.96
1986	18	712	2231	123.92	3133	1340	78.48	1882	66 76
1987	21	720	2420	115.22	3361	1809	86.15	2513	83.07
1988	27	690	2838	105.10	4113	2132	78 98	3090	63 49
1989	40	843	3456	86 39	4099	2358	58.91	2798	75.62
1990	49	840	4463	91.08	5313	3253	66 38	3872	80 98
1991	61	991	5672	92.97	5723	4246	70.22	4284	83 08
1992	71	1057	7151	94.42	6765	5164	72.73	4886	80.24
1993	76	1169	8261	108.70	7067	5543	72.93	4741	74 55
1994	83	1166	10227	123.21	8771	8077	97.31	6927	87.75
1995	90	1350	12669	140.77	9384	11533	128.14	8543	101.15
1996	95	1778	14027	147.65	7889	13539	142.52	7615	107.25
1997	100	1903	16557	165.57	8700	13095	130.95	6881	85.58
Annual Growth Rate(%)	**22.21**	**11.02**	**21.98**	**4.29**	**10.95**	**24.14**	**7.68**	**13.11**	**88.61 (Average)**

Source: Calculated from the information obtained from various Annual Reports of the IBBL.

Explanations:

Col. 2: Number of Branches
Col. 3: Number of employed persons
Col. 4: Total deposit mobilised in million taka
Col. 5: Deposit per branch (4/2) in million taka
Col. 6: Deposit mobilised per employee (4/3) in '000'taka
Col. 7: Total employed fund in million taka
Col. 8: Employed fund per branch (7/2) in million taka
Col. 9: Total employed fund per employee ((7/3) in '000' taka
Col. 10: Fund utilisation rate calculated as (col. 7 divided by 90% of col. 4) multiplied by 100

Last Row: Annual growth rates have been calculated by using the relation $Y = a + e^{bt}$. Here the coefficient 'b' is interpreted as the growth rate being estimated by the OLS method. Y is the variable, 'a' is constant and 'e' is exponential.

Table - 4
Sector-wise Investments of IBBL
(1987-1997)

(in Percentages)

Sector	1987	1989	1991	1993	1995	1997
1. Commerce	70.59	65.16	59.66	62.19	59.96	37.15
2. Industry	13.71	27.59	12.96	30.13	27.21	43.65
3. Agriculture	0.98	0.91	4.86	1.80	0.32	0.43
4. Real Estate	0.45	0.52	1.75	3.14	2.51	2.01
5. Transport	2.75	3.22	2.02	1.95	4.41	3.59
6. Others	11.52	2.58	18.75	0.79	5.59	13.17
Total	100.00	100.00	100.00	100.00	100.00	100.00
(million Tk)	**(1809)**	**(2358)**	**(4283)**	**(5543)**	**(11512)**	**(13075)**

Source: *Annual Reports,* Islami Bank Bangladesh Limited (various issues).

Table – 5
Comparison of Performances of the IBBL and Conventional Banks

CRITERIA	IBBL	ABBL	PBL
Profitability			
Spread/VWF	1.14	1.72	0.67
Burden/VWF	(0.22)	0.69	1.81
Profit/Volume of Working Fund (VWF)	1.36	1.03	(1.14)
Productivity			
VWF/Total Expenditure	17.25	11.08	10.18
VWF/Manpower Expenditure	87.53	116.23	55.22
Total Income/Total Expenditure	1.23	1.11	0.90
Total Income/Manpower Expenditure	6.25	11.95	4.37
Liquidity			
Cash to Deposit	22.91	13.76	13.27

Liquid Asset to Deposit	37.66	29.36	20.21
Contribution to national Exchequer			
Total in million taka	64.02	57.18	2.93
As % of VWF	0.71	0.69	0.03
Distribution			
Profit or Interest paid/VWF	3.92	6.67	3.47
Rural/Urban Ratio (1992)*			
Deposit	4 : 96	22 : 78	NA
Advances or Investments	2 : 98	20 : 80	NA
Banking Inequality Index (1993)**			
Up to 25	0.10	0.03	NA
25 to 100	0.11	0.07	NA
100 to 500	0.32	0.16	NA
500 to 10 000	0.81	0.69	NA
10 000 +	1.00	1.00	NA

Sources:

(a) For IBBL and ABBL, the relevant information is extracted from Alam and Misir (1998). The data refer to the average of the period 1988–1995. Calculation mistakes found in the published document have been corrected as far as possible.

(b) For PBL, the relevant information is extracted from the Islamic University Studies (1998). The data refers to average of the period 1988-1993. Calculation mistakes found in the original document have been corrected as far as possible.

(c) *: For Rural- Urban ratio, the relevant information is calculated from Ali Akkas (1997).

(d) **: For Banking Inequality Index, the information is calculated from Hasan M. Kabir (1997).

(e) NA = Not available

PART – V

PUBLIC FINANCE

'GIVE THE KINSMAN HIS, AND THE NEEDY, AND THE WAYFARER, AND SQUANDER NOT (THY WEALTH) IN WANTONNES. LO! THE SQUANDERERS WERE EVER BROTHERS OF THE DEVILS, AND THE DEVIL WAS EVER AN INGRATE TO HIS LORD' [BANI ISRAIL 17:25-26].

Chapter 13

ISLAMIC PUBLIC FINANCE : PAST AND PRESENT

[**Key concepts:** *Israf* *Daruriat* – *Hajiat* – *Tahsiniat* – *Din* – *Nafs* – *Nasl* – *Mal* – *Aql* – *Jihad* – *Kharaj* – *Jizya* – *Ghanimah* – *Khums* – *Fay* – *Dawah* *Fard Kifayah* – public utilities – foreign direct investment]

Public finance is concerned with the income and expenditure of the government. It has assumed a very important position in the modern economy. 'That government is best which governs least' is no longer valid in the modern days. Apart from maintaining internal peace and discipline and protecting the country from external aggression, the modern government is to perform some other functions including enhancing economic development. This chapter deals with the nature and extent of public expenditure and public revenues in an early Islamic period and in the modern days in the context of Islam. These, however, are preceded by Islamic principles of public finance as discussed below. Islamic fiscal polices (with reference to *Zakat* and taxes) are discussed in the following chapters.

1. PRINCIPLES OF ISLAMIC PUBLIC FINANCE

To begin with, let us see what guidance we have from the injunctions of the Quran and the *Sunnah* for making public finance in an Islamic perspective. These are named as Islamic principles of public finance. These are so called because of its three special characteristics as described in the first three principles namely *Zakat* as an integral part of public finance, prohibition of *Riba*, and special emphasis put on the prioritisation of public expenditure.

(i) Collection and disbursement of *Zakat*: *Zakat* is his third pillar of Islam and is regarded as a financial worship. Its collection and disbursement forms an integral part of the Islamic public finance. This principle owes its origin to the Quran i.e. 'Establish *Salat* (prayer) and pay *Zakat*' [**Baqara 2:43**].

(ii) Permission of trade and prohibition of *Riba*

One of the fundamental principles of Islamic public finance is to avoid *Riba* from all its transactions. This principle owes its origin to the Quran. That is, **'Allah has permitted trade and forbidden usury' [Baqara 2:275]**. According to this dictate, trade is permitted.

(iii) Prioritisation of Public Expenditure chapter

In Islamic public finance it is essential to allocate the available resources according to priority. Islamic jurists have classified public expenditure into three categories in order of priority as shown below:

(1) the necessary *(Daruriat)*
(2) the needed *(Hajiat)*
(3) the commendable *(Tahsaniat)*

According to Shatibi, a famous Islamic jurist, 'the necessary' *(Daruriat)* comprises the following items:

(1) religion *(Din)*
(2) life or self *(Nafs)*
(3) family or progeny *(Nasl)*
(4) property *(Mal)*
(5) intellect or reason *(Aql)*.

Other Islamic scholars like at Ghazali and al-Amidi also support protection of these five items. 'Needed' expenditures come next. These are necessary in order to reinforce the necessity. Commendable expenditures are encouraged only after the first two categories are satisfied.

(iv) Entitlement of return and the liability of loss

This principle implies that ownership can not be separated from the liabilities related to such ownership. This principle ultimately leads to profit-and-loss sharing business.

(v) Respect for contractual obligations

Islam demands that all contractual obligations must be written down and be respected with utmost care. The relevant Quranic instruction is: **'Ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing ....' [Baqara 2:282].** To safeguard the rights of parties to contracts, no ambiguities must be left: the terms and conditions must be clear.

(vi) Condemnation of extravagance (*Israf*)

Israf or unrestricted expenditure on the part of the government (also on the part of individuals) is condemned in Islam. As the Quran says, **'....and squander not (thy wealth) in wantonnes. Lo! the squanderers were ever brothers of the devils...' [Bani Israil 17:26-27].** The government with utmost economy must use the hard-earned money of the citizens of the country.

(vii) Establishment of justice to the poor

A very important principle of public finance in an Islamic perspective is to establish justice to the poor and needy. This principle also directly owes its origin to the Quran which states, **'Those who, if We give them power in the land, establish worship and pay the poor due and enjoin the right and forbid the wrong. And with Allah rests the final outcome of all events' [Hajj 22:41].**

(viii) Establishment of democracy

Islam demands that the power of the state in the matters of earning and spending money should be exercised in a democratic manner i.e., allocation of money for those activities, particularly for those which are not clearly specified in the Quran and the *Sunnah* (but

are not against the *Shariah)* relating to public interest are to be decided in consultation with the people, or in parliament. According to the Quran, **'... and consult with them upon the conduct of affairs' [Shura 42:38].**

(ix) Prevention of concentration of wealth

'In order that it (wealth) may not (merely) make a circuit between the wealthy among you' [Hashr 59:7]. This Quranic dictate implies that while raising resources from *Zakat* and taxes and mobilising savings from the public and spending the money for various purposes, the state must see that the wealth gets transferred from the rich to the poor so that the rich do not get richer and the poor poorer.

2. PUBIC EXPENDITURES AND SOURCES OF PUBLIC REVENUE IN EARLY ISLAMIC PERIOD

This section shows the nature and extent of public expenditure and public revenues in an early Islamic period. We begin with the heads of public expenditure.

(a) Heads of Public Expenditure + 202

The important heads of public expenditures during the life time of the Prophet and the caliphs were as under[1]:

(1) Procurement of horses and arms for the holy war (*Jihad)*;
(2) Buying freedom of the Muslim slaves;
(3) Provision of money to newly converted Muslims and also non-Muslims, for reconciling their hearts;
(4) Paying off the debts of the deceased poor;
(5) Meeting of the basic needs of the poorer sections of the society; and
(6) Payment of pensions.

[1] For details see, Ziauddin Ahmad 1992, p.368.

These heads of expenditure continued to remain important during the period of the Caliphs. Later, however, other functions such as development works and welfare activities were included.

(b) Sources of Public Revenues *202

In order to meet the expenses of the activities as specified above, the following were the sources for public revenues in an early Islamic period.

(i) *Zakat*: *Zakat,* was perhaps the most important source of public revenue in an Islamic state. In effect, it occupied the lion-share of the public revenue in those days. It is a compulsory payment due to the Quranic dictate i.e., **'Establish *Salat* (prayer) and pay *Zakat*' [Baqara 2:43].** The rate of *Zakat* is 2.5 per cent of the income. *Nisab* or exemption limit of *Zakat* on gold and silver are, 7.5 and 52.5 tolas, respectively. For other commodities, the rates of *Zakat* are obtainable from the *Hadith.*

(ii) *Kharaj*: In order of importance, *Kharaj,* or land tax, was next. During the early period of Islam, from the viewpoint of this type of taxes, land was classified into two categories, *'Ushr* land 'and *'Kharaj* land'. The former implies a land tax of 10% of the total produce (provided the produce reaches the *Nisab*): this was for the lands falling within Arabia. For the latter, on the other hand, the rate was not fixed. It was imposed on lands outside Arabia i.e., located in the countries conquered by Muslims.

(iii) *Jizya*: It was a kind of poll tax levied on all 'able-bodied' non-Muslims during the early days. This was treated as tax, for not taking part in the defence of the country. In return to tax, the non-Muslims were given all amenities and protection as their Muslim counterparts.

(iv) *Ghanimah* or *Khums*: *Ghanimah* refers to spoils of war and *Khums* to the proportion (one-fifth) of the spoils to be used by the state. According to the *Hadiths* of the Prophet, the remaining four-fifths were normally distributed among the soldiers participating in the war.

(v) ***Fay***: *Fay* includes all properties received either from the enemy without actual fighting or from the properties left without an heir or 'lost and found' without the claim from the owners. In early days of Islam, this was also an important source of revenue of the government.

(vi) Customs duties: This type of duties was first imposed during the time of the second Caliph Umar in response to similar taxes imposed by other states, which affected the Muslim businessmen.

(vii) Taxes on mines and treasure troves : There was a levy of 20% from the receipts from mines and treasure troves in the early Islamic period.

(c) Linkages Between Sources of Revenues and Heads of Expenditures on the Basis of the Quran

Before we proceed further, it would be interesting to see the linkages between the sources of public revenues and heads of public expenditures on the basis of the Quran and the *Sunnah.* The following are the findings.

(i) *Zakat*: The Islamic state has no option but to use the funds collected as *Zakat* according to the instructions given in the Quran. It says, **'The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors, and for the cause of Allah, an (for) the wayfarers; a duty imposed by Allah.' [Tawbah 9:60].** The eight heads specified here are: (1) the poor, (2) the needy, (3) the collector, (4) the newly converted Muslims, (5) freeing the captives, (6) the debtors, (7) the cause of Allah, and (8) the wayfarers.

(ii) *Ghanimah* or *Khums*: The heads of expenditure of the revenues obtained through this source has also been specified in the Quran i.e., **'And know that whatever ye take as spoils of war *(Ghanimah)*, lo! a fifth thereof is for Allah and for the messenger (i.e., for the state) and for the kinship (who hath need) orphans and the needy and the wayfarers, if ye believe in Allah...' [Anfal 8:41).** Thus by compulsion, one-fifth of the receipts of the spoils of the war needs to be spent for the state activities including the kinship,

orphans, the needy and the wayfarers. How the remaining four-fifth is to be spent is not specified in the Quran. However, as said above, this portion was normally used for helping the soldiers who actually participated in the war.

(iii) Fay: In the *Ayats* 6-10 of *Sura Hashr* of the Quran, the heads of expenditure of the revenues collected by *Fay* have been categorically specified. These heads are more or less similar to those specified for *Zakat* (i.e., *Sadaqa*). Basically the amount of *Fay* collection will have to be spent for the general benefit of the people living in an Islamic state.

3. PUBLIC FINANCE IN A MODERN ISLAMIC STATE

(a) Functions of a Modern Islamic State

The nature and extent of the public revenue and public expenditures of a modern Islamic state is determined by the nature and extent of the functions it has to perform. Nejatullah Siddiqi (1992) has mentioned three types of functions of an Islamic state. These are:

(1) Functions assigned by the *Shariah* on permanent basis;
(2) Functions derived from *Shariah* on the basis of *Ijtihad* (research) for the present situation; and
(3) Functions assigned to the state at any time and place by the people through the process of *Shura* (consultation).

The first category of functions is derived directly from the Quran and the *Sunnah.* These are permanent responsibilities of Islamic states. This includes such activities as defence and law and order.

The second category of functions includes those functions, which are not directly derived from the Islamic *Shariah* but are derived on the basis of *Qias* (analytical reasoning), or arguments based on *Masalah* (public interest). They are necessary for realising the objectives of *Shariah* as mentioned in category (1) above. This category is quite flexible and depends upon time and place. At present times, this may include such activities as protection of environment and scientific research.

The functions that are not covered by the above two categories but are on public demand are included in the third category. The necessary condition is that the decision to perform any function under this category must be decided in a democratic manner, i.e., through mutual consultation (*Shura*). This may include any function such as generation and supply of electricity and collection of *kharaj* revenue. Thus the list of this category of functions is open-ended.

Before we proceed further, some comments on the categorisation of functions of a modern state are in order. Since the first category of functions is directly derived from the Quran and the *Sunnah,* there is no comment on this. There may not be any comment on the second category of functions since they are derived by *Qias* and *Ijtihad*. However, the third category of functions has become subject of comments. For instance, according to Kahf (1983), the Islamic state is not necessarily free to set the economic and political priorities nor is it free to impose a pattern of government spending that may violate the freedom and rights given to individuals by Allah. He states that there are clear and strong texts in the Quran and the *Sunnah* that protect private property from 'any act of aggression' whether by the state or by the individuals.

Kahf is right in his own way of interpreting the Quranic dictates. The opinion given by Siddiqi has his support from the early Islamic traditions. As he himself, in support of his viewpoint, refers to a passage from Abu Yusuf's *Kitab al Kharaj* dating back to the second century after *Hijra* in which he advised the ruler of the time to undertake certain public works like cleaning of ancient canals and land reclamation because people of the time wanted the ,state to undertake this type of activity.[2]

(b) Principles of Public Expenditure

There are well-defined principles of public expenditures in the Islamic economics literature. The following principles have been derived by Chapra (1992, p.289) from the articles of *Majallah.*

[2] see Ahmad, Ziauddin 1992, pp. 372-73, for details.

Principle 1: The principal criterion for all expenditure allocations should be the well being of the people: This principle implies that an Islamic government will not make any spending arbitrarily. It must have a purpose. The overall purpose of government spending is human welfare. This welfare, of course, includes both material welfare and spiritual welfare. Expenditures on infrastructure including rural infrastructure and agricultural extension services, education including character building, health including safe water supply, sanitation and malnutrition, housing and public transport system are some examples in point.

Principle 2: The removal of hardship and injury must take precedence over the provision of comforts (and luxury): This means that public spending should first be directed to meet the basic needs of the society. In other words, according to this principle, preference should be given to projects that help remove the hardship and sufferings caused by the prevalence of malnutrition, illiteracy, homelessness and epidemics, and lack of medical facilities, safe water supply and sewage disposal.

Principle 3: The larger interest of the majority should take precedence over the narrower interest of a minority: This principle implies that if there is a choice between the import of cars and buses, for the greater interest of the majority, the government should opt for the latter as the majority of the population uses buses rather than cars in the developing countries (we are dealing with). This also implies that in the developing countries, since majority of the people lives in rural areas, rural development programmes must have priority in the development agenda of the government.

Principle 4: A private sacrifice or loss may be inflicted to save a public sacrifice or loss, and a greater sacrifice or loss may be averted by imposing a smaller sacrifice or loss: We can continue the above illustration for this principle too. Cars definitely provide comforts to the urban people. This transport is more convenient than the buses. On the other hand, buses are less convenient but are used by majority of the people. A ban or reduction of the import of cars

would bring inconvenience to some but that should be sacrificed for the greater interest of the majority of the urban population, who are poor.

Principle 5: Whoever receives the benefits must bear the cost: This is a very important principle. This means that if the benefit of a particular project (say, construction of a small dam in a remote locality) is to be financed, its cost should be borne by the beneficiaries (that is, by those persons who directly derive the benefit of the project). Toll collection from the vehicles crossing the bridge is another example in point.

Principle 6: Something without which an obligation can not be fulfilled is also obligatory: Suppose the *Shariah* categorically demands that inequalities of income and wealth must be reduced, but it says nothing specifically about the development of the cottage industries. If it happens that without developing the cottage industries, it becomes impossible to raise the incomes of the poor and hence reduce the gaps between the rich and the poor, then it becomes an obligation on the part of the government to take all necessary measures in order to develop the cottage industries.

(c) Heads of Public Expenditure

As stated above, Siddiqi has identified the heads of expenditures of a modern Islamic state based on three classifications, namely, permanent heads, heads based on present circumstances and heads based on people's demand. These are discussed below.

(i) Permanent expenditure

The heads of expenditure are called permanent because they are all derived directly from the Quran and the *Sunnah* and the Muslims have no alternative but to obey.

Defence: To defend the motherland from external aggression is the foremost duty of a modern Islamic state. Allah dictates that **'Against them make ready your strength to the utmost of power, including steeds of war, to strike terror into (the hearts of) the**

enemies of Allah and your enemies, and others besides, whom ye may not, but Allah doth know.'[Anfal 8:60]. Therefore, the Quranic injunction of defending the motherland is absolutely clear and hence would represent an important head of public expenditure.

Law and order: Maintenance of internal security has been regarded as one of the crucial duty of the state since the early days of Islam. Of necessity, this should represent an important head of public expenditure in any state. Ibn Tahir al-Baghdadi, has a very appropriate example to make: 'the *Shariah* has a number of laws that cannot be implemented except by the ruler or one who governs on behalf of the ruler, such as implementing *hudud* (penal laws) on free persons'.

Justice: It is well-known duty of the Islamic government to obey the Quranic instruction i.e., **'Allah commands justice (*adl*) and doing good (*ihsan*) and liberating to kith and kin...' [Nahl 16:90].** A good proportion of government fund would therefore be necessary to act upon this divine instruction.

Need fulfilment: The Prophet, after establishing *Baitul Maal*, declared, 'If anybody dies leaving property, that belongs to his heirs, and if anybody dies leaving orphans and widows empty handed, then I am their heir'. In effect, according to Islamic principles the state remains responsible for meeting the basic needs of its people. These include food, clothing, shelter, education, health, etc. Given the nature of activities under need fulfilment, it would perhaps be one of the most significant heads of public expenditures in the modern days.

***Dawah* (Invitation):** The need for this specific head of expenditure, along with other heads, is found in the Quran in several places. For instance, in the Quran it is dictated that **'Let there arise out of you a band of people inviting to all that is good, enjoining what is right, and forbidding what is wrong: they are the ones to attain felicity' [Al-Imran 3:104].** Thus in an Islamic state *Dawah* i.e., communicating the message of Allah to all mankind forms an important head of public expenditure.

Civil administration: By definition, the government will have to allocate some money for administering the activities narrated

above. This head of expenditure is quite popular among the students of general economics.

***Fard Kifayah* (social obligation):** In an Islamic state, this *fard kifaya* is also an important head of public expenditure. This duty is, however, not compulsory for all individuals but are addressed to society or community. The condition is that it must be performed, otherwise the whole society would be condemned. From Islamic economics point of view, this includes functions arising out of natural calamities. The Islamic jurists have even gone to the extent of including all 'productivities on which fulfilment of basic needs such as food, clothing and shelter depends.' (Siddiqi 1991, p.80). What is important to remember in this case is that the matters should generally relate to public goods and that the failure of the individuals to act upon them would become the responsibility of the state.

(ii) Expenditure based on present circumstances

It should be recognised that Islam is a dynamic religion and its dictates are both inflexible (i.e., binding under all circumstances, *ceteris paribus,*) and flexible (i.e., changeable with given circumstances). The following heads of expenditure are derived from the *Shariah* with reference to present circumstances.

Protection of environment: Protection of environment has now become more crucial than any time before. This is a public good the benefit of which is enjoined by all individuals without causing any harm to anybody. Because of the huge costs involved in such activities as protecting the environment, keeping the air pure, saving the water from pollution, and preserving wildlife, individuals may not come forward to perform these activities. It is, therefore, natural that protection of environment accounts for some portion of public expenditure, of any modern state.

Scientific research: It is widely said that Muslim countries have become more dependent on the advanced countries simply because they do not give the importance to scientific research. This type of research is necessary particularly for economic development, which is an important objective of a modern Islamic state. Viewed in

this way, scientific research would call for huge expenditure on the part of the government in modern times

Capital formation and economic development: This head of expenditure does not find explicit mention either in the Quran or in the *Sunnah*. Nevertheless, this is extremely important according to the precepts of the Islamic jurists like Ibn Taymiyah, al-Qurtubi and al-Amidi. The universally accepted principle in this regard is that 'whatever is necessary for discharging a duty is itself a duty.' If the government is to perform such duties as need fulfilment and continued improvement of standard of living, the need for capital formation and economic development can not be ignored. If the state desires that its people should become *Zakat*-givers rather than *Zakat*-takers, it must make all out effort for capital formation and economic development.

Subsidies: In the Islamic state, private persons are encouraged to share a large burden in the matters of need fulfilment not only for themselves but also for their society in terms of *Dawah* activities and scientific research. These activities require huge expenditure, without, in most cases, any tangible direct benefit. It is desirable, therefore, that the Islamic state should come forward and give subsidies to those individuals who are associated with these types of activities.

Stabilisation policies: Prevention of wide fluctuation in the levels of economic activities, price level, etc., it is necessary to ensure *Adl* and *Ihsan* in the society and pave the way for economic development. For the Islamic government, this would serve as an important head of expenditure.

(iii) Expenditure on activities assigned by the people

Islam supports democracy. Allah loves those **'who (conduct) their affairs by mutual consultation' [Shura 42:38].** The activities which are not included in the above two lists {(a) and (b)} but are demanded by the people (or by the parliament of an Islamic State) call for state action and hence forms an important head of expenditure. To derive support of this viewpoint, Nejatullah. Siddiqi (1991) refers to a passage from Abu Yusuf's *Kitab al Kharaj* dating back to second

century Hijra in which he advised the ruler of that time to undertake certain public works such as cleaning of ancient canals and land reclamation because people of that time demanded the state to undertake that type of activity. The government may charge the local people to the extent the benefits accrue to them.

(d) Sources of Revenues of a Modern Islamic State

Section 2(b) has given an account of sources of public revenue of the early Islamic period. All these sources are applicable in the modern days too; but given the wider scope of the government activities, they may not be adequate. Moreover, some of these sources might not get their applications in the present time. *Ghanimah* or *Khums, Jizya, Fay* may be cited as some examples in point. On the other hand, in the present day world, the sources that are used for revenues may not be permitted in so far as the principles of *Shariah* are concerned. This necessitates an examination of sources of revenues of the modern state from an Islamic perspective. There are basically two sources of revenues of a modern Islamic state: internal and external. Both these sources are discussed as under.

(i) Internal Sources

Zakat: For an Islamic state, *Zakat* represents the most important source of revenue. Its application is universal. It is a compulsory levy on income and wealth, 2.5% of the total, if the that income exceeds a certain minimum level, called the *Nisab*. While it is the religious duty of the Muslims to pay *Zakat*, the Islamic state is required to make administrative arrangement for its collection and distribution. According to Monzer Kahf, *Zakat* may provide up to 5% of the total GDP generated in the public sector of the Muslim countries. It is also regarded as a source of revenue, which helps achieve just distribution of income and wealth in the society. Some Islamic states like Pakistan, Sudan and Iran have already established a system of collecting and distributing *Zakat*.

Given the nature and extent of state functions in the modern age, the revenue collected through this head, even when properly

administered, will not be sufficient to meet the needed expenditure. Other sources of revenue will, therefore, have to be explored.

Taxation: Taxation, as a source of public revenue, occupies a very crucial position in the theory of public finance as developed by the western economists. This source naturally provides a lion-share of government's revenue in all the modern states including the Muslim ones. It not only helps mobilise resources for meeting government expenditure but also serves as a significant policy instrument for maintaining monetary stability and reducing inequalities in income and wealth. The vital question is: Can an Islamic state use taxation as a source of revenue in the presence of *Zakat* without any qualification? In the following paragraphs an attempt is made to seek an answer to this question.

The Islamic economists are in fact divided on the question of taxation as a source of revenue in the Islamic state. Those who are against taxation argue that the Quran and *Hadiths* say nothing specifically about taxation on income. Even the early jurists made no reference to this (Kahf 1986, p.32). Kahf, referring to the writings of early Islamic jurists categorically states that Islam does not support the active tax policy in order to bring about substantial reduction of income inequalities (Kahf 1973). Those who are in favour of this are of the opinion that although the Quran is not specific about taxation, there are clear hints in it which gives clues to this type extra income. Hasanuz Zaman shows by detailed analysis that the word *Infaq* (i.e., spending, referred so frequently in the Quran) actually gives rise to this type revenue (see Zaman 1993)[3]. Chapra categorically states that 'in view of the goals of social justice and equitable distribution of income, a progressive tax system seems to be perfectly in harmony with the goals of Islam' (Chapra 1985, pp.-42-43). Kahf actually does not appear to be wholly against taxation when he says, '...there was simply no need for taxes at times of abundant non-tax sources' (Kahf 1986, p.32). This implies that if the *Zakat* revenues are not sufficient

[3] For details, see the next chapter.

to meet the needed expenditure of the government, it may resort to taxation.) However, in spite of the differences of opinion regarding the place of taxation in the modern Islamic state, it is accepted that it should be kept within reasonable limits.

Borrowing: In the modern days borrowing is regarded as an indispensable source of public revenue. Question has been raised in the Islamic economics literature as to whether borrowing is at all permissible in the eye of Islam. In this regard, the views as expressed by Siddiqi, one of the best known Islamic economist, is of quite significance. He says, 'No injunction in the Quran nor in the *Sunnah* prohibits it nor have researchers discovered any rules that might require such a prohibition. On the contrary, there are examples in the *Shariah* of practical steps to be taken for obtaining loans, and scholars of Islam have clarified the situation by stating that circumstances can arise where the Islamic states will need loans.' (Siddiqi 1983, p.130-31). It is also known from the history of the early Islamic period that loans were contracted by the state though in most cases this was done to meet emergencies. (Hasanuz Zaman 1981, pp. 105-106 and 275-76).

The most common form of borrowing is from the central bank of the country. In economics, this is popularly known as **deficit financing.** This is a permissible source of finance in Islam, provided of course that it is not interest bearing. It should, however be borne in mind that large scale financing through this may lead to inflation which is regarded as unIslamic by the Islamic jurists. Therefore, this source should be used only under compelling circumstances.

Human resources: The last, but not necessarily the least in order of importance, domestic source of financing economic development of a modern Islamic state is the under- and un-utilised human resources. Many Muslim countries including Bangladesh have huge population. In the past, little attention has been given to them on the grounds that they are poor, illiterate, assetless and, and above all, culturally backward. However, some institutions like the Grameen Bank (although not necessarily in an Islamic way) has proved beyond doubt that if the poor can be properly organised and are given sincerely and efficiently supervised financial help they can be turned

into assets and can contribute significantly towards economic development of the country. If labour does have zero productivity in agriculture, it can be withdrawn and put to work on investment projects like construction, irrigation works, road buildings, etc. without any adverse impact on the production of agriculture. As most of the additional wages will be directed towards foodstuffs, agricultural income will rise. The higher income can easily be taxed. When the investment projects are completed there will be an increase in output, and some of this increase in income can be captured through taxes.

(ii) External Sources

There are two purposes for which external sources are used. These are: to supplement domestic resources available for capital formation and to fill the foreign exchange gap. The following three external heads are used as sources of revenues of the modern state. These are discussed with reference to the principles of Islam.

External borrowing: For developing countries, external borrowing is treated as a very important source of financing their development expenditures. Generally loans are available on the basis of interest only, which is strictly prohibited in Islam. The amount of loan that is available from such institution as IDB is utterly negligible. Thus, although the Muslim countries very badly need external loans they can not use interest-bearing loans. However, on the basis of the doctrine of necessity, a temporary exception is sometimes allowed by Islamic jurists. For example, the Council of Islamic Ideology in Pakistan has given the ruling that 'For the time being, external borrowings (i.e. state to state borrowings) will have to be continued on the basis on interest'. However, attempts should be made to gradually eschew all interest-best borrowings.

Foreign aid: Although the net contribution made by the large inflow of foreign aid in the developing countries appears to be controversial, its necessity can not be denied. There are Muslim countries which still heavily depend upon foreign aid for financing development expenditure. This is not undesirable from the viewpoint

of Islam, provided there are no anti-Islamic constraints attached to it. There are a large number of Muslim countries, which have sufficient surplus funds, and these can hopefully be utilised for financing the needed expenditure of the poor brothers of other Muslim countries.

Foreign direct investment: Foreign direct investment (FDI) is presently being considered as a very promising source of revenue for both developing and least developed countries. There is keen competition among them for attracting FDI. This is advantageous for both the investors and the host countries. For the investors, overseas investments can offer very attractive opportunities in the form of lower wage costs, access to cheap raw materials, possibility to secure foreign markets, exploiting economies of scale and above all various attractive incentives by the host countries. On the other end, for the host countries, this source of finance provides a unique combination of long-term finance, transfer of technology, training, managerial expertise and marketing experience and above all the contract in international markets. From Islamic standpoint, this source has special merit: this provides an opportunity to switch the dependence from the interest-based foreign financing to equity-based financing. The IDB can play a very dominant role in popularising the joint venture type projects using such *Shariah* permitted instruments as *Mudaraba* and *Musharaka*. (36

In conclusion, it may added that for meeting the basic needs of the people Allah has given abundant resources, natural and human. As the Quran says, **'It is We who have placed you with authority on earth and provided you therein with means for the fulfilment of your life' [Araf 7:10].** What is required is to make all out efforts to exploit the available natural and human resources for the benefit of mankind.

REFERENCES FOR FURTHER REDAING[4]

1. Nejatullah Siddiqi (1991), 2. Nejatullah Siddiqi (1992), 3. Ziauddin Ahmad (1992).

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[4] For detailed, see the list of references given at the end of the Book.

Chapter 14

ISLAMIC FISCAL POLICY : THE ROLE OF *ZAKAT*

[**Key concepts:** *Zakat* - *Nisab* – Tax *Sadaqa* – *Zakatable* items – rate of *Zakat* – stabilisation – allocative role – working poor – *Fakir* – *Miskin* - distributive role]

Zakat is one of the five pillars of Islam: it is the third one. Order of paying *Zakat* is almost concurrent with *Salat* or prayer in the Quran. **'Establish *Salat* (prayer) and pay *Zakat*' [Baqara 2:43].** It occupies a central place in the Islamic fiscal policy too. This chapter deals with the conceptual issues and shows overall role of *Zakat* in the socio-economic development.

1. CONCEPTUAL ISSUES

(a) Meaning of *Zakat*

Etymologically the word '*Zakat*' means 'that which purifies'. It purifies wealth. According to the Quran, it is nothing but an *Ibadah*, an act of worship, just like *Salat*. From economic point of view, it is a tax-like levy imposed on the rich persons having a minimum level of wealth (called *Nisab*) and hence represents transfer payment from the haves to the have-nots. The essential feature of *Zakat* as a worship is what makes it the third pillar keeping in mind that the first pillar (*Iman*) takes the form of a mental worship, the seond (*Salat*) takes the form of a bodily worship, and this third pillar (*Zakat*) takes the form of a financial worship. Ordinarily, the rate of *Zakat* is 2.5% and *Nisab* is 7.5 tolas gold or 52.5 tolas silver or values thereof.*

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* 7.5 tola gold = 87.00 gram gold
52.5 tola silver = 624.00 gram silver

(b) *Zakatable* items

(i) Items subject to *Zakat*

The principal items on which *Zakat* is payable include: (1) cash in hand or in the banks, (2) gold, silver or ornaments made thereof, (3) trading goods, (4) produce of mines, and (5) herd of cattle.

(ii) Items not subject to *Zakat*

Zakat shall not be payable by an assessee in respect of the following wealth, not being stock-in-trade, owned by him:
(1) land, (2) all buildings that house such establishments as mills, factories, warehouses, stores, (3) shops, (4) houses, (5) cattle below one year of age, (6) all clothing and household linen, (7) paper, books and printed matters, (8) all household furniture, utensils and equipment, (9) all domestic fowls and birds, (10) machinery, tools and instruments, (11) conveniences, (12) arms and ammunition, (13) all perishable agricultural products, (14) seeds for sowing, (15) wealth acquired and spent within the assessment year, and (16) wealth devoted to charitable purposes owned by charitable organisations.[1]

(c) Rate of *Zakat* and *Nisab*

Although the rate of *Zakat* is popularly known as fixed, actually it depends upon the nature of items concerned. The most popular items, *Nisab* and the rates are given below.[2]

Chart-1
Items of *Zakat, Nisab* and Rates

Wealth	*Nisab*	Rate of *Zakat*
1. Agricultural produce	1. Five *wasq* or 42 maunds or 1,568 kgs. per harvest	1. Five per cent of the produce in case of irrigated land and 10 per cent in case of non-irrigated land

[1] This list is taken from 'A Draft of *Zakat* Act' *Thoughts on Economics*, Islamic Economics Research Bureau, 1980, p. 117.
[2] Ibid p. 125.

Wealth	*Nisab*	Rate of *Zakat*
2. Gold, silver, or ornaments made thereof	2. Seven and a half tola of gold or 52.5 tola of silver	2. Two and a half per cent of the value
3. Cash in hand or at bank	3. Value of 52.5 tola of silver	3. Two and a half per cent of the amount
4. Trading goods	4. Value of 52.5 tola of silver	4. Two and a half per cent of the value of the goods
5. Cows and buffaloes	5. Thirty number	5. For every 30, one 1-year old; for every 40, one 2-year old
6. Goats and sheep	6. Forty number	6. One for first 40; 2 for 120; 3 for 300; and 1 more for each number
7. Produce of mines	7. Any quantity	7. Twenty per cent of the produce

(d) Distinctions between *Zakat*, Tax and *Sadaqa*

At this stage it would be useful to show the distinguishing features of *Zakat* vis-à-vis tax and *Sadaqa*. This is shown in the form of a chart below.

Chart-2

Distinction between *Zakat*, *Sadaqa* and Tax

Zakat	Tax	*Sadaqa*
1. *Zakat* is a compulsory payment imposed by Allah.	1. Tax is a compulsory levy imposed by the government.	1. In a sense, *Sadaqa* is also a compulsory payment imposed by Allah.
2. It is a levy on the accumulated wealth above a certain level.	2. It is a levy on *income* above a certain level.	2. It does not depend necessarily upon tangible income.
3. Its payment involves money.	3. Its payment also involves money.	3. Its payment does not necessarily involve money: it can be simply a gesture.
4. It is a religious duty applicable only to Muslims.	4. It is a duty for all citizens of a country to pay tax.	4. It is a religious duty of the Muslims.
5 *Zakat* must be spent on the heads as specified in the Quran.	5. The tax proceeds can be utilised for any purpose as decided by the authority in question.	5. Although not specified as *Zakat*, it must be spent for Allah's pleasure.

Zakat	Tax	*Sadaqa*
6. It is basically for the poor.	6. It is for all.	6. It is also for all.
7. The payee cannot expect any quid-pro-quo in this world but can expect reward in the Hereafter.	7. The taxpayer individually can not expect any direct quid-pro-quo from the receiver of tax.	8. Like *Zakat*, the payee can not expect worldly benefit but can expect spiritual benefit.
8. There is a defined minimum level of wealth below which *Zakat* does not become due.	8. For direct tax, there is a minimum level of income below which tax is exempted.	8. There is no such limit.
9. Its rate is taken as fixed and invariable.	9. Its (direct tax) rate is not fixed, rather may increase with the level of income.	9. There is no fixed rate.
10. It is to be paid regularly.	10. It is also to be paid regularly.	10. Not regularly paid.

(e) Conditions of *Zakat*

For the payment of *Zakat* certain conditions need to be fulfilled. Some of the conditions specified by the Islamic scholars are described below.

(1) **Muslim:** *Zakat* is a compulsory payment but that is only for the Muslims. This is because it is one of the five pillars of Islam. Allah says, **'Take from their wealth a *Sadaqa* in order to purify them and sanctify them with it, and invoke Allah for them. Verily! Your invocation are a source of security for them' [Tawba 9:103].** This verse is addressed to Muslims and not to the disbeliveers. It is the Muslim who needs purification. Therefore, *Zakat* is not to be collected from the non-Muslims.

(2) ***Takleef*:** The word ***Takleef*** refers to legal competency for obligation. Some scholars have placed the conditions of baig (reaching the age of puberty) and sanity (intellectual and emotional stability) for the mandate of *Zakat*. They say that *Zakat* is not compulsory on the wealth of those who are not competent to observe the precepts of religion. After all *Zakat* is an act of worship.

(3) **Intention:** The validity of *Zakat* depends upon one's intention. The one paying the *Zakat* should pay it to its recipients, believing that it is an obligation to be discharged. As one *Hadith* says, 'The value of one's deeds is determined by one's intentions (**Bukhari**)'. Since *Zakat* is an act of worship, it should be associated with intention.

(4) **Complete Possession of Wealth:** The meaning of complete possession of wealth is that the wealth must be in the hand of the person paying *Zakat* and that the wealth must be free from any rights by others. The person paying the *Zakat* must have the right to dispose of and use the wealth as he wills.

(5) **Ownerless Wealth:** For the ownerless wealth there will be no *Zakat.* This money or wealth should, of course, belong to the state in which the poor can claim due share.

(6) ***Waqf*:** Money from such sources as mosques, fighters in the path of Allah, orphans and schools are not subject to *Zakat* according to sound opinions of Islamic jurists.

(7) **Unlawful Wealth:** Unlawful wealth may include wealth attained from theft, extortion, forgery, bribery and cheating. Islamic code demands that these money should be returned to the rightful owners or their inheritors. If one does not know who they are, then the money should be given to the poor and the needy. If a person is insistent upon keeping possession of this type of wealth, and the wealth is still present after a complete year has passed, it then becomes liable to *Zakat.*

When a debt is involved, who is responsible to *Zakat* on it, the lender or the debtor? Is the debt even subject to *Zakat*? The majority of the scholars have classified the debts into two categories namely, good debt and bad debt. If a debt is acknowledged by the debtor with a willingness to repay, it is a good debt. The lender should pay *Zakat* on it according to the stated principles. If, however, there is no hope of getting back the debt, it is a bad debt and there is no *Zakat* on it.

(8) **Increased Wealth:** Wealth should be such that it produces a profit or benefit to its owners. The Prophet clearly avoided

Zakat on wealth used to meet the genuine requirement of livelihood or for personal use. So there will be no *Zakat* on wealth saved for basic requirements such as food, clothes, housing and other basic needs.

(9) ***Nisab***: *Zakat* is payable on any amount of growing wealth that reaches *Nisab*.

(10) **One Complete Islamic Calendar:** An important condition of *Zakat* is that the wealth of the person must be in possession for complete one *Hijri* (lunar) year. This condition is related to money, livestock and commercial commodities.

(f) The Recipients of *Zakat*

There are eight categories of the beneficiaries of *Zakat*, which Allah Himself has specified in the Quran. That is: **'The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors and for the cause of Allah, and (for) the wayfarers; a duty imposed by Allah' [Tawbah 9:60].** The recipients as mentioned in this verse are described below.

(1) The poor *(al-Fukara)*

(2) **The needy *(al-Masakin)*:** The poor and the needy as mentioned above are defined as those who do not have their basic needs fulfilled. In other words, they do not possess the *Nisab*, that is, an amount in excess of their essential needs with regard to food, drink, clothing, housing, animals, tools of their trade, and similar other necessities. They qualify for *Zakat*.

It may be of some interest to point out that in the Islamic literature, the exact meaning of the Arabic words, *al-Fukara* and *al-Masakin*, are highly confused. There are scholars who opine that *al-Fukara* refers to those persons who are poor but 'do not beg' and *al-Masakin* to those who are poor and 'beg'.[3] There are others who hold

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[3] See '*Zakah:* Spiritual Growth and Purification' by A. M. at-Tayyar (original), published in *Al-Jumuah*, Vol. 19, Issue 8/9, **Ramadan,** 1419H (1998-99)., pp. 42-43.

just the opposite view. That is, *al-Fukara* refers to those persons who are poor and 'beg' and *al-Masakin* to those who are poor but 'do not beg'. Although this type of difference of opinion will have no impact on the method of selection of recipients, it is better to accept the later view. This is based on the following *Hadith:*

> 'The needy person *(miskin)* is not one who goes around asking the people for a date or two, or a mouthful or two, but the one who is too embarrassed. .... Or, who has not enough money to satisfy his needs and whose condition is not known to others' **(Bukhari** and **Muslim).**

What is important to remember is that both *Fakirs* and *Miskins* are poor and they are first recipients of *Zakat.* This *Fakir-Miskin* would of course include the unemployed wage earners and labourers, and those who are forced to leave their own countries due to one reason or other and the persons who are physically disabled and age-old crippled.

(3) The collectors: These are persons that the authority in question employs to collect *Zakat.* These persons may be engaged in various works including collecting, recording, guarding, dividing and distributing *Zakat.* The authority may pay their remuneration out of the funds collected on this head.

(4) The converted: *Zakat* can be used for reconciling hearts of those who have been converted to Muslims. It is often seen that the people who embrace Islam are forced out of their kith and kins and are sometime deprived of a source of income. These people have the right to receive *Zakat* to protect themselves from harm and to make their faith firm. Scholars also agree that this fund can be used to attract the hearts of those who are inclined to Islam.

(5) **Freeing slaves:** *Zakat* funds can be used to buy a slave and then free him/her. It is expected that when these slaves become free, they would be able to worship Allah and would eventually become useful members in the community.

(6) The debtors: The debtors are those people burdened by debts because of personal and family needs. They have borrowed

money but do not have money to repay the debt. They are living hand to mouth. Islamic jurists also opine that if anybody has borrowed money for social necessities such as spending on an orphan, reconciling between Muslims, or renovating a Masjid or School, and becomes unable to repay, this debt can also be paid out of *Zakat* funds. This holds true even if he is wealthy.[4]

(7) Preaching: Preaching for the cause of Allah is another outlet of *Zakat* funds. Jurists, however, differ in the exact meaning of the term. Some have limited it to the fighters in the path of Allah, even if they were wealthy, if they do not receive wages from the Islamic Treasury. Others say that this also includes acts that make one closer to Allah. Therefore, anyone that strives in the obedience of Allah, and performs good deeds deserves *Zakat*.

(8) The wayfarers: Finally, *Zakat* funds can be used for those persons who need financing aid to complete their journey. The 'wayfarer' is sometimes defined as a traveller stranded in a foreign land and is in need of money in order to achieve his objective or to return to his country. This person can receive *Zakat*, provided, of course, that the purpose of journey is lawful. Allah warns us, **'Help one another in righteousness and piety, but do not help one another in sin and transgression' [Maida 5:2].** Some Islamic economists have even gone even to suggest that under this head, the *Zakat* funds can be used for repairing roads, buildings, etc. for the convenience of the travellers.

Zakat not-Deserving Person

Having described the recipients of *Zakat*, we may add a few words about those who are not eligible to receive *Zakat*. They are:

(1) **The wealthy:** Islamic jurists are in complete agreement that no wealthy person should be given *Zakat* from the shares of *Fakir*

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[4] See ibid., p. 43.

and *Miskin.* They can become recipients only when they are employed to collect *Zakat*, attracting the hearts of the non-Believers, fighters in the path of Allah and the wayfarers.

(2) **The strong and healthy:** *Zakat* is forbidden to anyone capable of working and earning a living unless he can not find a job or he finds a job but the money received is insufficient for him and his family. The reason behind this prohibition is that these people are commanded by the *Shariah* to work and support themselves. They are not supposed to lie back and depend on others.

(3) **The disbeliever:** Jurists agree that it is forbidden to spend *Zakat* on the disbelievers for this will constitute supporting them and their disbelief. *Zakat* funds are expected to be used for the benefit of the poor and needy Muslims only.

(4) **Fathers, sons and wife:** Islamic jurists agree that it is not permissible to give *Zakat* to one's wife, father, grandfather, mother, grandmother, son, grandson, and the daughter or her children. This is because if one pays *Zakat* to them, then it would imply that he has not fulfilled his financial obligations towards them. This is equated to giving *Zakat* to himself. However, giving *Zakat* to other relatives – such as brothers, sisters and others – is permissible, when there is no obligation to take care of them. This is even better because one receives the rewards of *Sadaqa* and of keeping good relations with them.

(5) **The family of the prophet:** The family of the Prophet did not receive *Zakat* because they took their share from the booty gained from war. Normally, it is held that the family of the Prophet is the Banu Hashim and Banu Abdul-Muttalib and the prophet himself forbidden to pay *Zakat* to his *Ahl-e-Bayet*.

(g) Principles of Distribution of *Zakat* Funds

Islam not only specifies the *Zakat* recipients, as discussed above, but also provides the principles of its distribution. Some of the important principles are mentioned below.

(a) *Zakat* funds should be distributed among the persons as specified in the Quran [Tawbah 9:60]

(b) *Zakat* proceeds must be distributed as soon as they are collected. This is because the recipients of *Zakat* are badly in need of this. By definition, they are very poor.

(c) It is desirable to spend the *Zakat* funds in the areas from which it is collected. This act is expected to strengthen the bond of brotherhood and create a healthy atmosphere of mutual co-operation in the community.

(d) During the period of inflationary pressure, a greater portion of the proceeds of *Zakat* should be distributed in the form of producer goods and during the period of depression, preference should be given to cash or consumer goods.

(e) The funds must be distributed in such a way as to maximise the social and economic benefits of the recipients. This should not only help the recipients get rid of their poverty but also help increase their living standards so that they ultimately become *Zakat*-payers rather than always remain as *Zakat*-receivers.

In order to implement the last principle, it would be necessary to categorise the poor beneficiaries into 'non-working poor' and 'working poor'. The non-working poor are those who are basically unemployed, have nothing to do. They can be treated as 'wage-labourers'. Truly speaking, this is the category of the people who need *Zakat* funds most. Given their socio-economic status, *Zakat* funds will have to be given to them through transfer payments. This should be immediately realised that this type of help would, in turn, help them buy some goods and services, which would, in turn, help them only to survive. Without further measures, their status can not be raised above the poverty line.

The working poor, on the other hand, may be defined as those who are engaged in some activities, say, production of agricultural commodities, handicrafts, small shops, petty business, etc. Because of one reason or other, these people are not in a position to make any headway in their professions. These people need help, a special type of help, such that they can increase their productivity in their

respective professions. Transfer payments would certainly not help these people to the extent needed. They will have to be provided with the supply of necessary inputs, help in marketing their produce, provide the needed amount of capital, etc.

2. ROLE OF ZAKAT

(a) Objectives of *Zakat*

The socio-economic objectives of *Zakat* may be stated thus:

(a) To help the rich Muslims get rid of their lust for wealth and purify it;

(b) To help redistribution of income and help alleviate poverty;

(c) To achieve social justice; and

(d) To create effective demand, which would, in turn, help boost up

(b) Socio-Economic Impact of *Zakat*

Zakat, if properly administered, can produce a significant impact on the socio-economic aspects of the economy. Its effect have in fact been studied intensively. Some of the important impacts are discussed below.

(i) Alleviation of Poverty

It is generally believed that, as compared to tax, since the *Nisab* for the levy of *Zakat* is low and the base for the levy is fairly wide, *Zakat* has the potential for mobilising substantial resources for the alleviation of poverty. But in the countries where incidence of poverty is wide spread, *Zakat* alone will not be sufficient to remove or eradicate poverty. Available empirical studies show that it has not been possible to mobilize more than one-half percentage of GDP as *Zakat* in those Muslim countries where it is administrated by the state on compulsory basis. After all *Zakat* is a redistribution measure while

the roots of poverty in most Muslim countries lie in productivity and level of economic development.*

(ii) Impact on Distribution

By definition, *Zakat* means transfer of income from the haves to the have-nots. Islamic economists are in complete agreement in that if *Zakat* (along with other institutional mechanism) is faithfully handled, it can play a major role in the elimination of gross inequalities of income and wealth as found in most countries of the present world, including the Muslim ones, irrespective of their stages of development. Al-Tahir made a simple comparative static situation study of the effects of *Zakat* on the income gap between the rich and the poor in a 10-year period and concluded that, under his assumptions, this gap gets reduced from 9 to 6.5 times. Zarqa ascertains that *Zakat* doubles the income of the poorest 10% of the society every year since most of it is taken from the rich and given to the poor.[5] Therefore, *Zakat* helps break concentration of wealth in few hands which is condemned in Islam [**Hashr 59:7**]. *Zakat*'s distributive role involves an allocative role, too, as the *Zakat* funds mostly used on essential goods and services. This implies that factors of production will be diverted from the production of luxuries to the production of necessaries.

(iii) Impact on Free Loan

Zakat has eight category of recipients. One of these is the debtor. If debtor has incurred the debt for lawful cause and is unable to pay back, then *Zakat* funds can be used for helping him/her to repay

* The study of Islamic history however, reveals that during the period of *Khulafa Al-Rashid-oon*, there were surpluses of *Zakat* at least in Yemen and Egypt. This does not mean that there were no poor people to secure *Zakat*. Actually what happens is that the poor were so conscious and self-reliant that they checked their desire to accept *Zakat*. (see details in Kahf 1999).

[5] Both these examples are taken from Kahf 1992, p.184.

it. Qaradawi points out a very interesting impact of *Zakat* in the following words:

> 'If society provides extra protection for the creditor it means people will be more willing to finance interest free loans (*Qard Hasan*) because of the knowledge that *Zakah* is liable to reimburse the lender if the debt was incurred in good faith' (Qaradawi, as quoted in Zarqa 1992a, p.154).

(iv) Impact on Consumption

Empirical studies are in abundance in the economic literature to show that the Marginal Propensity to Consume (MPC) is comparatively very high for the poor people when compared to the rich. Will the final outcome be a higher or lower aggregate propensity to consume in an Islamic economy? One opinion is that the poor people constitute the bulk of the population of the most Muslim countries. Since *Zakat* involves transfer of income to the poor who have high MPC, this implies that the aggregate consumption expenditure of the economy would increase. Given the deficiency of effective demand in these economies, higher consumption would certainly serve as a favourable factor for growth and employment. The other opinion is that it is difficult to determine the direction of the aggregate consumption after *Zakat* is effectuated: it may either be neutral or at best inderminate because of contradictory effects on income of the poor and the rich. (Kahf, 1999).

(v) Impact on Savings and Investment

Ceteris paribus, *Zakat* will have negative effect on savings. In other words, private savings above *Nisab* will get reduced if no effort is made to invest it. This rather punitive nature of *Zakat* should encourage one to invest one's idle savings. Thus *Zakat* by imposing a penalty for keeping resources idle actually helps push resources into productive sectors and hence produce positive impact, rather than negative impact as stated earlier, on savings.

It is necessary to emphasise that Islam urges the people not to keep their savings idle . The Prophet also were aware of this rather unacceptable consequence and therefore 'urged those responsible for the management of wealth belonging to orphans to invest it so that it would not suffer gradual erosion due to *Zakat.* This request of the Prophet teaches the Muslims to make ***Zakat* payments from the earnings generated from one's wealth rather than from idle wealth itself.'** (N. Hasan 1991, p.214-15). *Zakat* collection and distribution increases employment through two mechanisms: (i) creating new jobs for the management of *Zakat* itself, and (ii) transferring some segments of recipients into productive workers by means of distributions in the form of training, rehabilitation and capital goods. This is why the Quran says, '**But will give increase for deeds of charity' [Baqara 2:276]**.

(vi) Impact on Stabilisation

If sufficient funds are available, some portion of it can be used as a counter-cyclical device. That is, if during the inflationary situation some *Zakat* proceeds are kept in reserve and release the same during the depressed period, this would produce positive impact on stabilisation of the economy. *Zakat* as an anti-inflationary device can be more effectively effectuated through appropriate disbursement policy. According to Islamic scholars, during inflationary pressure, attempt should be made to distribute a greater portion of the proceeds of *Zakat* in the form of producer goods and during the depression period preference should be given to cash or consumer goods. This should, however, be regarded as a special measure.

(vii) Impact of Product-mix

From welfare point of view, sometimes it is required to bring about a change in the product-mix. *Zakat* has a role to play in this regard. It brings about a transfer of purchasing power from more affluent sections of the population to the poorer sections. As the latter would have more demand for essentials, it is highly probable that the product-mix of the country will get changed.

(viii) Impact on Political Power

As said above *Zakat* helps redistribution of income from the rich to the poor. Mabid Mahmod (1974, pp. 41-44)) has established a correlation between distribution of wealth and distribution of political power. He finds that the degree of association between the distribution of wealth and that of political power increases with size of the political unit measured in terms of the number of voters. He concludes that the association between the distribution of wealth and that political power can be broken by a redistributive scheme. The scheme operates on wealth, and not income. This is designed in such a way that it automatically checks accumulation on an asset by asset basis, taxing more remunerative assets more heavily. Obviously, *Zakat* fulfils all the conditions of such a redistributive scheme.

3. SOME CONTROVERSIAL ISSUES

Before concluding this chapter, it would be of importance to discuss some controversial issues arising out of the administering the *Zakat* collection and distribution.

The Quran has made the payment of *Zakat* as compulsory as *Salat.* But it has given no details about it, particularly about its rate, *Nisab* and *Zakatable* items. It is from the *Hadiths* that one can get the necessary details. Most of the *Shariah* scholars, however, opine that the information that one derives from the *Hadiths* are invariable and cannot be altered under any circumstance. The Islamic economists (including some *Shariah* scholars), on the other hand, think that there is scope for change not only in the rate of *Zakat* but also for *Nisab* and the coverage of *Zakatable* items, keeping, of course the spirits of the Quran and the *Sahih Hadiths* in tact The nature of controversy is discussed as follows.

(a) The Rate of *Zakat*

According to the *Hadiths* of the Prophet, the rate of *Zakat* is 2.5% on accumulated wealth, whether they are in terms of gold, silver, trading goods or cash. The rate is, however, flexible for domestic animals (see section 1(c) above).

A number of recent writers have advocated for flexible *Zakat* rate. Afazuddin Ahmad (1952), Izadi (1974), Mahmud Ahmad (1972) and others have argued that the rate of *Zakat* should commensurate with the ability to sacrifice of the taxpayers. This is actually the principle of 'equal sacrifice' of the modern economics and is taken as the basis of the progressive rate of taxation.

Mannan has argued in favour of flexible *Zakat* rate but on a different footing. He makes a distinction between money income and real income and maintains that in money terms, the rate of *Zakat* should be inflexible as dictated by the sayings of Prophet; but in real terms the rate may be changed so as to reflect the change in the cost of living. In support of his argument in favour of flexible rate of *Zakat* he also draws evidences from the early days of Islam. For example, only a few years after the death of the Prophet 'Caliph Omar ... did in fact change the rate of *Zakat* once, even though he decided to change it back to old rate.' (Zaman 1980, p.78, as quoted by Mannan 1984). Moreover, the Prophet exempted horses from *Zakat* although this referred to riding horses. It is shown that Omar levied *Zakat* on horses. Again, in modern times, the coverage of *Zakat* has extended to all new forms of wealth (i.e., shares, securities, rented buildings, provident funds, etc.), not known in the early days of Islam. (Mannan 1984, p.343).

The preceding discussion, therefore, shows that there is a case for flexible rate of *Zakat* to suit to the changing world. One may even go further to argue that since Islam is for all mankind and for all time to come, silence in the Quran about the details of *Zakat* may speak in favour of flexible *Zakat* rate according to the socio-economic circumstances prevailing in the society concerned. However, the decision of changing the rate of *Zakat* should be taken with utmost care. It must be seen that the final decision must not go against the spirit of the Quran the *Sahih Hadiths*. If, however flexible rate of *Zakat* is at all found justifiable through *Ijtihad*, the additional revenues derived out of *Zakat* must be spent for the poor, and only for the poor.

(b) *Nisab* of Wealth

Nisab, i.e., minimum exemption limit of *Zakat* has also come under discussion. This level as stated above is fixed at 7.5 tola of gold or 52.5 tolas of silver or their cash equivalents. Siddiqi (1980, p.23) in one of his writings reported that a number of recent writers had advocated for reassessment of *Nisab*. This is necessitated on the ground that the socio-economic realities of all the Muslim countries are not similar. These vary quite widely from one Muslim country to another. For example, the per capita income of Bangladesh (one of the least developed countries) is US$360 and this is US$10,540 for Saudi Arabia (one of the middle income countries) and US$17,390 for Kuwait (one of the higher income countries), as in 1997.[6] Zaman (1980, p.78) maintains that if the proposal for reassessment of *Nisab* gets supported by the *Shariah*, it would be necessary to define the level of income which is required to maintain a reasonable standard of living for a Muslim. He also suggests that their minimum but adequate income should be periodically adjusted to reflect the changes in the cost of living.

(c) *Zakat* on Machinery and Capital Goods

This is another controversial issue, which requires attention of the Islamic scholars. The basic question is whether machinery and capital goods should be subject to *Zakat* or to be treated as *Zakat*-free. If these are treated *Zakatable*, what should be their rates? Mannan has quoted a long paragraph from Siddiqi's study which shows the opinions of the different Islamic scholars. For example, Maududi regards only the marketable produce of industrial units to be subject to 2.5% annual tax, like all other merchandise, exempting machinery and capital goods installed in these units from *Zakat*. Akram finds this view to be inconsistent with Maududi's opinion on Zakat of shares in industrial concerns. Abu Zuhra advocates a 10% tax on the net income (profits) of these concerns. Qardawi endorses his view subject to two

[6] World Development Indicators, 1994. Per Capita income for Kuwait refers to 1995.

important modifications. Firstly, he categorises rented buildings and vehicles on hire and also such enterprises as poultry farms and dairy farms along with industrial units. Secondly, in all these cases he advocates a 10% levy on profits net of depreciation costs.

Mannan is of the view that capital goods and machinery are the 'produced means of production'. So it is net income (profit) from the marketable produce of industrial units which should be subject to *Zakat.* However, he opines that *Zakat* should not be based on the value of the capital goods and machinery since in that case the source of income would be adversely affected. The rate of *Zakat* should be determined on the basis of social desirability of the industry concerned. In other words, the rate of *Zakat* should be linked with not only productivity criterion but also with the social desirability criterion. For arriving at a final conclusion it is required to do more research in this case. (Mannan 1984, p. 342)

(d) Voluntary vs. Obligatory *Zakat*

Still another source of controversy is the mode of administration of *Zakat*. The question is whether the mode should be obligatory administered by the state or voluntary administered by the people themselves. The Quran is silent about it. Islamic history is also not conclusive. Thus, during the early period of Islam, in Makkah, the *Zakat* was unregulated and strictly voluntary in nature. After the *Hijra* in Madinah, it became a formal payment administered the state-appointed agents and enforced, where necessary by military might. The system, however, got changed during the periods of the Caliphs. That is, *Zakat* was administered in a decentralised manner, the agents of enforcement being peer pressure, fear of Allah and the individual's own conscience.

Against the background, most Islamic scholars believe that it is the state which should take the responsibility of collecting and distributing *Zakat*. But, to others, this would appear to be non-workable in most Muslim countries. In a country like Bangladesh *Zakat* should be left to the individuals. If the state takes this responsibility it will create an additional administrative problems. The

Zakat funds must not be mixed up with other sources of revenue such as taxes.

(e) Methods of Zakat Collection

Generally, two methods of *Zakat* collection are seen in Islamic economics literature: deduction at source and direct payment by Zakatable persons. By the same token, estimation of the due *Zakat* by using general guidelines and variables such as amount of imports by a merchant, level of education of a professional or number of employees in a craftsman's shop may lead to figures of *Zakat* proceeds different from those that can be obtained by actual calculation made by *Zakat* officers on a case by case basis, and also different from an estimation that depends on national accounts and its sub-sectoral data.

4. SOME PRACTICAL EXPERIENCES OF STATE-ADMINISTERED *ZAKAT*

In most Muslim countries (including Bangladesh) *Zakat* is not administered by the state. Among countries, where *Zakat* is administered by the state, Pakistan (from 1981), Malaysia Sudan, Yemen (from 1951) and Saudi Arabia (from 1981) are prominent. Some experiences of these countries are noted briefly as under.[7]

Firstly, the rates and coverage of *Zakat* items are quite diverge. It is found that both Pakistan and Saudi Arabia have extended the obligation to companies. These companies are treated as juristic persons. In addition, they have imposed a flat levy on certain types of bank deposits. Saudi Arabia levies *Zakat* on imports, at rates varying from commodity to commodity. Pakistan allows farmers to deduct their expenses on fertilisers and insecticides. The rate is 5% on all farm output, regardless of the modern irrigation. In contrast, in Malaysia, each farmer is granted a fixed exemption, but no deductions are allowed for modern production costs. It effectively exempts

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[7] These are collected from Kuran 1993 pp.319-324 and Kahf 1999. Available information belongs to the year 1991 through 1996.

industrial workers, bureaucrats, businessman and shopkeepers, as well as the growers of rubber, coconuts, and other tropical cash crops.

Secondly, *Zakat* systems vary greatly from country to country in terms of yield. In Pakistan it did it exceed 0.35% of the GDP as indicated in the statistical year book. Of this only 8% is derived from agriculture. This unexpectedly low contribution of agriculture is said to be due mainly to the difficulty of compelling the rich and powerful landlords to pay the dues. In Saudi Arabia, this percentage was only between 0.4% and 0.6% during the 1991 to 1996. Housing, for obvious reason, is exempted from *Zakat*. This implies that there must have been restrictive coverage and large-scale evasion in all these countries. Incidentally, evasion takes a variety of forms, disguising or under-declaring one's cultivated acreage, under-reporting one's crops, and handing over to the *Zakat* collector spoiled all adulterated grain. In Sudan, *Zakat* proceeds ranges between 0.3% and 0.5% of the GDP.

Thirdly, there are also variations in terms of distributive mechanisms. In Pakistan, *Zakat* revenues are channelled by the *Zakat* Administration to thousands of local committees. These committees ultimately decide whom to support with the funds. The funds are allocated among the committees roughly according to the population they represent. This implies that relatively poor communities generally receive more than their contribution to the *Zakat* funds. According to official records, during 1980-88 period, 58% of the *Zakat* funds were used as subsistence allowance to enable people to work, including widows, orphans, and the handicapped. But the grants, as one would expect for developing countries like Pakistan, involved were too small to make a significant difference in the living standards of such groups. In 1980s, when an individual needed an estimated $22 a month just to survive, most *Zakat* payments varied between $4 and $8 per individual, in some cases much less. The system covers about one million beneficiaries, which represents about 10% of the total people apprehended to be living below the country's poverty level.

Another important finding of Pakistan's *Zakat* administration is that about 20% of its funds has been allocated to rehabilitation during period 1980-88. Under the programme many poor women received sewing machines. But because of lack of training and

materials on the part of the recipients this good programme has not been able to accrue substantial benefits.

In Malaysia, its federal structure assigns the administration of *Zakat* to an office at the state level. Collected funds are forwarded to the *Zakat* office in each state for distribution. As an illustration, it may be interesting to refer to *Zakat* office in Alore Setan (capital of Kedah). In 1970, out of total proceeds 53% went toward commendable measures (generally religious education), 6% to people making a pilgrimmage to Makkah, 2% to converts, 22% as commissions to the *Zakat* collectors and central administration, leaving the rest 15% for the poor. Figures for the early 1980s show that disbursements to the poor ranged between 11 and 13 percent. Those included in the list of recipients received $3 and $19 a year. In 1993 out of the total among of *Zakat* distributed (RM 29.28m) 11% were used for Fakir and Miskin and as much as 76% were for *Fi sabil allah.* In 1997, this distribution pattern got substantially changed, the former being raised to 24% and the later reduced to 64%.

A major difference between Pakistan and Malaysian system lies in the source of compensation for officials of Zakat administration. In Malaysia, officials are paid out of *Zakat* revenue as per the instruction of the Quran. In Pakistan, they are paid out of general government funds.

Fourthly, another interesting experience of *Zakat* administration of these countries is that, in Pakistan, Shite Muslims, because of their objection, are exempt from contributing to the government-administered fund. In Malaysia, some individuals feel that obligatory payments are not adequate to fulfil their religious obligations. Accordingly, they make additional payments to people of their choice. Payments to the government is often referred to as '*Zakat Raja*' (literally means 'Ruler's *Zakat*') and the voluntary payments are called '*Zakat* Peribadi' or personal *Zakat*. In Pakistan too is additional payment is made by the rich people. This implies that *Zakat* transfers more wealth to the poor than shown by the official records by the countries in question.

Fifthly, *Zakat* can produce substantial impact on employment through its collection and distribution. Both theory and practice put something on the proportion of *Zakat* proceeds that can be spent on

employment in the *Zakat* organisation. It is known that the Shafits suggest a ceiling of 12.5% of total proceeds for labour compensation in the *Zakat* organization while the late Ahnaf take this ceiling upto 50%, if need arises. In practice, Sudan limits it to 10%, while Saudi Arabia and Pakistan keep this portion intact for distribution to other recipients categories especially the poor and needy.

Sixthly, experience shows that there has been serious difficulties in collecting *Zakat* on cash and current account balances held by individuals in Sudan, Saudi Arabia and Yemen. In Pakistan, although it was possible to deduct *Zakat* on current accounts at the source it was found difficult to collect *Zakat* on trade inventories and on cash balances held by both companies and individuals.

It is noticed that certain countries impose *Zakat* on certain items that are left outside the legal collection in some others countries. For instance, while the prevailing general attitudes in Pakistan and Yemen and of the Board of High Learned Scholars in Saudi Arabia stand for the traditional view that requires fulfilment of the condition of holding an item for one year in order to become *Zakatable*, Saudi Arabia itself collects *Zakat* from several professional income items without looking at this yearly conditions. Again earned income generated from long term investment on fixed assets, such as building, tractors and trucks, are included in the *Zakatable* items in Sudan, while such earnings are left un*Zakatable* in Saudi Arabia, in spite of their similarity with the *Zakatable* professional income. Such an element may have precedence in the historical application of *Zakat*. For instance, Ibn Jubair, in the story of his journeys from Muslim Spain to the eastern Mediterranean countries around the end of the 6th century of *Hijrah*, reports that *Zakat* offices at the port of Alexandria, Egypt, used to charge *Zakat* on all travellers for all the items they carry with them without taking the trouble of distinguishing between trade merchandise and items of personal use.

REFERENCES FOR FURTHER READING[8]

1. IERB (1980), 2. M. A. Mannan (1984), 3. Nik Hasan (1991) 4. Shah Muhammad Habibur Rahman (1996).

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[8] For details, see the list of references given at the end of the Book.

Chapter 15

ISLAMIC FISCAL POLICY : THE CASE OF TAXATION

[**Key concepts:** *Infaq* – *Sadaqa* – *Ushr* – Islamic tax structure – tax as last resort – just tax system – mix of direct and indirect taxes – defence tax – linking tax and *Zakat* – *Zakat*-deserving people]

As a source of public revenue, tax plays a very dominant role in the modern economy. It alone accounts for some fourth-fifths of the total revenue income (as in Bangladesh) and covers around one-third of the total national income of most of the Muslim countries. In an Islamic economy, however, the role and scope of taxation as a means of mobilising resources is not straightforward. Its objectives and structures are quite different from those of the modern economy. This chapter, therefore, attempts to show the justification, objectives and the structural design of the taxation system from an Islamic perspective.

1. JUSTIFICATION OF TAXATION IN AN ISLAMIC ECONOMY

(a) Levy System During the Early Days of Islam

In the literature, lack of agreement can be noticed among the Islamic economists regarding the place of taxation in an Islamic economy as a source of government revenue. This arises simply because the Quran, the most important source of Islamic knowledge, says nothing specific about taxation, either for good or for bad. It mentions only two compulsory levies namely, *Zakat* on Muslims **[Tawbah 9:103]** and *Jizya* on protected non-Muslims **[Tawbah 9:29]**. The Prophet and his first Caliph (Abu Bakr) confined

themselves to these two levies and used others (e.g., one-fifth of booty) as a supplementary source only. Some *ad hoc* funds were of course collected through donations and other measures.

However, as time passed on, these sources were found to be too inadequate to meet the expenditure of an expanding economy. It was the second Caliph, Umar, who started imposing additional levies in the form of *Kharaj* (land tax) and *Ashoor* on trade. A once for all tax on excess income and wealth of government officers and a tax on horses were also imposed. The historians as an extension of *Zakat* have described the later two sources. Revenues derived out of these sources were too abundant to seek any additional sources during those days. In other words, in the strict sense of the term, taxation system as we find in present days was not there: the need for such taxes was not felt either.

Although nothing specific has been said about taxes in the Quran in the sense we use the term in the modern economics, Hasanuz Zaman (1993) has shown that the Islamic approach to taxation can be determined under the guidance of such Quranic words as *'Infaq'* and *'Sadaqa'*. Before we proceed to show this, let us say a few words about the concepts, *Infaq* and *Sadaqa*. It would be also of importance to relate these concepts to *Zakat*.

(b) Some Relevant Concepts

(i) Meaning of *Infaq* and *Sadaqa*

'Infaq' literally means spending. It refers to any spending whether for good cause or for bad. Note that in the Quran spending by unbelievers for opposing the religion has also been termed as *Infaq* **[Anfal 8:36]**. It can be made of anything to any extent at any time and the spender may legally expect moral, material or social benefits out of it. *'Sadaqa'*, on the other hand, refers to spending (i.e., *Infaq*) for Allah's pleasure only. In other words, *'Sadaqa'* and *'Infaq'* become interchangeable only when the latter also refers to spending for Allah's pleasure only. This also implies that *Infaq* is a broader term and encompasses general *Sadaqa*. It should be pointed out that *Sadaqa* not only refers to spending in money terms but also it may

refer to simply gesture, a word spoken or a service rendered. 'The best *Sadaqa* is to learn a point of knowledge (*ilim*) and teach it to your Muslim brothers' (**Ibn Majah**). In this sense, the scope of *Sadaqa* would appear to be broader than that of *Infaq*. It is, therefore, not at all surprising that *Sadaqa* has been made compulsory for all Muslims irrespective of their socio-economic circumstances.

(ii) Conditions under which *Infaq* and *Sadaqa* become indistinguishable

If *Infaq* is to be qualified as *Sadaqa*, in addition to Allah's pleasure, it has to fulfil some other conditions as implied in the Quran. Some of these are:

- It is to be made from one's own earnings **[Baqara 2:195]**.
- It should be done scrupulously without any desire for publicity **[Nisa 4:38]**.
- Its amount should be determined by the capacity of the spender **[Talaq 65:7]**.
- The amount should be such that it becomes neither 'extravagant' nor 'miserly' **[Furqan 25:67]**.
- When given, the giver should not expect any reward from the receiver: such *Infaq/Sadaqa* is termed as *qard hasan* **[Baqara 2:245]**.

This does not mean that everybody should always spend the entire balance that remains after normal daily expenditure and repayment of loans. In this regards some quotations from sayings of the Prophet seem relevant:

- 'It is better for you to retain something (than giving the entire surplus as *Sadaqa*).' (**Bukhari**).
- 'The best *Sadaqa* is one that leaves you well-to-do' (**Bukhari**).

(iii) Scopes of *Infaq*, *Sadaqa*, and *Zakat*

The Quran is specific about the heads of expenditure of *Zakat* funds **[Tawbah 9:60]**. In so far as these heads are concerned, *Sadaqa* becomes indistinguishable from *Zakat*. However, it (*Sadaqa*) has

additional heads of beneficiaries including parents, other near relations, orphans, neighbours, fellow workers **[Baqara 2:177** and **Nisa 4:36].**

An interesting feature of *Infaq/Sadaqa* is that the financial standing of its beneficiaries is ignored. As one *Hadith* says, 'Beggar has a right even though he visits you on a horse back' (**Abu Daud**). All these imply that there are no restrictions in the list of beneficiaries of *Infaq/Sadaqa* in so far as the Quran and the *Sunnah* are concerned.

Further, *Zakat* is treated as obligatory. Can *Infaq/Sadaqa* be regarded as obligatory? Or is it merely permissible or desirable? The rich reward in the Hereafter that is associated with *Infaq* and *Sadaqa* and the condign punishment that is forewarned on non-observance of these acts ,[1] suggests that they are more than desirable. They should rather be regarded as obligatory as noted in the Quran. For instance, **'Spend your wealth for the cause of Allah....'[Baqara 2:195]** or **'Spend out of (the bounties) We have provided for you, before the Day comes ...'[Baqara 2:254],** etc. Therefore, it can be stated that payments of *Infaq/Sadaqa* are obligatory although the details are not given like *Zakat.* The details would certainly vary from person to person according to income, size of agricultural holdings, liabilities, and social and professional requirements. In effect, 'fixity of the nature of wealth and amount or rate have been skipped in favour of honest personal judgement on the individuals' (Zaman 1993, p.23).

It may be argued that the scope of *Sadaqa* is the widest, since it can be given both in monetary and non-monetary terms. The non-monetary expenditure is expected to exceed the unholy expenditure as implied by *Infaq*. The scope of *Infaq* is narrower than *Sadaqa* but wider than *Zakat. Zakat is* paid only in terms of money (or wealth that is tangible). Its scope is naturally the narrowest.

Thus *Sadaqa* encompasses both *Infaq* & *Zakat.* Moreover, of the three words, *Infaq* is the most frequently used in the Quran (more

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[1] 'They who hoard up gold and silver and spend it not in the way of Allah, unto them give tidings of a painful doom' **[Tawbah 9:34].**

or less 60 times) and the other two words, *Sadaqa* and *Zakat,* are used less frequently (more or less 15 and 30 times, respectively). Although, *Sadaqa* is less frequently used in the Quran, it is most frequently used in the *Hadith* (Zaman 1993, p.18).

(c) The Road from *Infaq/Sadaqa* to Taxation

From the above discussion, a number of conclusions can be drawn:

- The acts of *Infaq* and *Sadaqa* are as obligatory as *Zakat* (and even *Salat);*
- Although the heads of expenditure for *Zakat* is specified, those of *Infaq/Sadaqa* are almost open-ended;
- Since the rates, slabs, limits, etc. are not specified for *Infaq* and *Sadaqa*, the authority in question can handle them in accordance with the prevailing circumstances;
- The rulers of early days of Islam made no attempt to institutionalise the acts of *Infaq* and *Sadaqa* simply because the nature and scope of the state activities did not warrant them. That is, the revenues collected from compulsory heads such as *Zakat, Ushr, Kharaj* and voluntary contributions obtained through *Sadaqa* and others were sufficient to meet the extended state expenditures of those days.

The last point needs further elaboration. Although the act of *Infaq/Sadaqa* was not institutionalised, there was a magical hand in it Hasanuz Zaman, by quoting several *Hadiths*, arrives at the following conclusions:

- In some cases a job was assigned to those who volunteered to perform it
- In some other cases a group of persons was nominated to perform the job.
- In another occasion the entire population was required to contribute to the maximum extent without any exemption or excuse. (Zaman 1993, p.25).

All these imply that in order to finance various expenditures, in addition to the voluntary contributions, the government may resort either to nominate a group of persons having the capacity to bear the burden or it may make the entire population to share it.

Strictly speaking, these ideas have gradually died out because of the absence of that magical hand, or more practically, because of lack of institution. In early days, the need for formal institution to materialise those ideas was not felt, because during those days, the Prophet's advice was taken as obligatory. 'Thus the task of removing shortage of water, or playing host to some tribal delegations, or supporting the slaves who deserted enemy ranks or even the financing of the Prophet's biggest campaign of Tabook were all managed through *Sadaqa* or *Infaq.*' (Zaman 1993, p.24). Unfortunately, this scenario will not find its application in the modern leadership. The socio-economic circumstances of the population, including those of the Muslims, have undergone fundamental changes. Zaman has very nicely drawn the picture as shown below:

> 'Quite contrary to the conditions of early Islamic society the contemporary Muslims unfortunately lack in every merit. Aberration, materialism and absence of socio-mindedness speak against relying on their fine conscience. Unprecedented increase in the population of the Muslim *Ummah* with scarce resources has led to innumerable social and economic problems which cannot be solved through actions. Free-riders far out-numbered sincere volunteers and social service organisations to frustrate any serious effort of socio-economic uplift...As a result the law abiding persons content themselves with conferring their contributions mostly to their nearest ones... and feel as if they have compiled with the injunctions of doing *Infaq*' (Zaman 1993, p.27).

All these imply that the act of *Infaq* should be regulated and institutionalised so that everybody can contribute towards social and economic development. **This can be possible only if this compulsory contribution is introduced in the form of tax.** Hence, it can be concluded that the tax system that we find in the modern days

can be traced back to such Quranic words as *Infaq* and *Sadaqa,* the latter with, of course, Islamic flavours.

(d) Justification of Taxation in Islam[2]

An Islamic state has a 'right' to tax in addition to *Zakat;* and the Muslims are also under 'obligation' to pay taxes in addition to *Zakat.* These have been defended by a number of jurists representing practically all Schools of Islamic jurisprudence such as Hanafi, Shafi, Maliki amd Hanbali, although the term 'taxes' has not been used.[3] The explanations are given below.

(i) The 'Right' to Impose Tax

- Perhaps the most important justification for the imposition of tax, in addition to *Zakat*, is that the purposes for which these are to be used, from the *Shariah* point of view, are not necessarily the same. By the Quranic injunction, *Zakat* funds can not be used for purposes other than those specified in *Sura* 9, *Ayat* 60. Strictly speaking, the expenditure needed for the general well being of the people is not mentioned in that list. Therefore, for meeting the obligation required by the *Shariah,* the government will need to impose taxes.
- The government of an Islamic state is under obligation to help remove the hardship and sufferings of the people caused, for example, by the prevalence of malnutrition, illiteracy, homelessness and epidemics. 'Something without which an obligation can not be fulfilled is also obligatory' (**Majallah**). According to this maxim, since it is not in most cases possible to perform this function with *Zakat* funds, the Government will have the right to impose taxes.
- The fact that a tremendous emphasis is placed on *Infqq* as explained above also adds support to this. That is, *Zakat* alone must not be charged with all responsibility of social welfare.

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[2] Adapted from Chapra (1992, pp. 295-99).

[3] The terms used include *Duraib, Wazaif, Kharaj,, Nawaib* and *Kilaf al-Sultaniyyah.* All these terms imply more or less the same thing` as taxes.

• A thorough reading of the Islamic literature reveals that the main reason for questioning the right of the government to impose taxes in addition to *Zakat* is that 'the permission to tax would be misused and become an instrument of oppression'. This stand is really surprising and does not establish an irrevocable precedent. As Qaradawi has rightly opined, 'the obligations of the state were limited at that time'. Ibn Tamiyyah forbids evasion **even when the taxes are unjust** on the grounds that the non-payment of their dues by some tax-payers will lead to the carrying of an unduly greater burden by others.[4]

(ii) The 'Obligation' to Pay Tax

• The obligation to pay taxes can be derived from one *Hadith*, which says, 'in your wealth there are obligations beyond the *Zakat*'.

• The Muslims are obliged to help the state, by way of taxes and other contributions, to perform the functions of a modern Islamic state effectively.

• The people get services, either directly or indirectly, from the state, including internal and external security, roads and transport, seaports, airports, water supply, street cleaning and sewerage system. For these services, it is required that the Muslims must pay taxes to the government.

• In support of taxes in the Muslim society, Chapra goes even to the extent of saying that, 'Since taxes represent mainly payment for services enjoyed directly or indirectly by the taxpayers, the effort to evade taxes in a Muslim society is not only a legal crime but also a moral offence punishable by God in the Hereafter' (ibid. p. 298).

• The example of the first Islamic society in Madinah is also very indicative in this regard. It was a society that depended on raising production along with voluntary contributions through *Sadaqa*, *Infaq fi-sabil-Allah* and *Awqaf*, a lot more than through the obligatory *Zakat* itself.

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[4] See Chapra 1992, pp. 296-8.

It may be of importance to note that M-Al. Husaini, in his book, *A Summary of the Fiqh of Zakah*, says, 'Taxes don't forgo the *Zakah* or replace it because the *Zakah* should be spent in certain manners and to specific recipients. There are special conditions and requirements in collecting it, its rate, and who should pay it'.[5]

2. OBJECTIVES OF TAXATION POLICY IN ISLAM

Many Muslim economists have tried to suggest the objectives of taxation policy in an Islamic perspective, although they are not in complete agreement. The following may be suggested as objectives of taxation policy for an Islamic economy.

- To supplement the government revenue
- To maintain justice and equity in the society;
- To allow every Muslim citizen to contribute to the society irrespective of their socio-economic circumstances; and
- To curb unemployment and inflation and thereby promote economic growth.

3. DESIGNING ISLAMIC TAX STRUCTURE

As objectives the tax structure of an Islamic economy would be quite different from that of the capitalistic system. In the following, an attempt is made to construct a design for an Islamic tax system.

(a) Tax as Supplementary Government Revenue

Islam gives proper emphasis on the development of the private sector. Accordingly, it is suggested that the state should make an all out effort to eschew taking on such activities as can better be performed by the private sector. Kahf opines that taxes should be imposed only after exhausting all other resources. He in effect suggests four measures to be undertaken by the Islamic state before resorting to taxation. These are:

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[5] As quoted in *Al Jummah* (USA), vol. 10, *Ramadhan*, 1999, p.44.

(1) Imposing taxes should not finance expenditure trimming, that is, the activities, which are not socially desirable.

(2) Financing development undertakings by means of private participation, i.e., the development projects, which can be designed on profit basis and financed by private persons, should not be financed by the state.

(3) Selling public goods for fair prices, or fees. and

(4) Voluntary and forced public borrowing. This should also be explored before resorting to taxation.

Other Islamic scholars, however, appear to have made no such rigid conditions for taxation as a source of revenue in an Islamic state. For instance, Chapra in one of his writings very clearly states that 'in view of the goals of social justice and equitable distribution of income, a progressive tax system seems to be *perfectly* in harmony with the goals of Islam' (Chapra 1980, p.161).

Against this background, it may be concluded that in an Islamic economy, tax should be regarded as an important supplementary source of government revenue.

(b) Purpose of Tax

In an Islamic economy, the purpose for which the tax is to be imposed is very crucial. Purposes of an Islamic state may be divided into two broad categories - subsistence welfare and desired welfare. Subsistence welfare functions of a state include those activities, which are needed for meeting the basic needs of the people i.e., food, clothing, shelter, education, and health and sanitation. The Islamic economists are in complete agreement in that the Islamic state will be fully authorised to raise necessary resources through additional taxation in order to meet the subsistence standard of all the people of the society. However, opinions differ regarding the latter. Kahf, for instance, categorically states that the Islamic state is authorised to resort to taxation only for meeting what he calls 'obligatory functions of the Islamic state' and the 'desired functions can only be undertaken if there are sufficient non-tax resources available to the state' (Kahf 1986, pp.33-34).

However, 'a majority of Islamic scholars believe that the Islamic state should also attempt to promote an egalitarian economic and social order. An Islamic state has the ultimate responsibility of protecting the collective interests of the society and is authorised to take direct action whenever necessary' (Iqbal 1991, p.109).

The arguments given above, although apparently are in contradiction, does show that the Islamic state may use the tax proceeds for any development activities but it is not allowed to make any wasteful expenditure as Islam very strongly condemns 'extravagance and wasteful spending'.

(c) Tax Must be Just

Many great Islamic scholars like Al-Ghazali, Ibn Taymiyya and Mawardi suggest that justice in the distribution of the burden of tax must be maintained. Truly speaking, imposing taxes on the poor contradicts the principle of *Zakat* itself as well as guaranteeing a minimum standard of living. Most burden should fall on those who have the capacity to bear, *the ability-to-pay principle* of the modern tax system. It is also suggested that the taxation policy should be such that it brings about a more equitable distribution of income and wealth in the society.

(d) Not to Destroy Incentives

In designing the tax structure in an Islamic state, it is necessary to ensure that it does not discourage investment and that the incentive/disincentive effects of taxation policy do not run counter to the goals of Islam. For instance, it has been observed that high corporate profit tax acts counter to the introduction of a profit-sharing system of financing. High taxes on profit encourage the businessmen to under-declare their profits in the case of *Mudaraba* arrangemnets. In fact, high rate of taxation are now being disfavoured even in the Western countries because of their adverse effects on private sector activity. The rate should, therefore, be such that it does not penalise the honesty and create unIslamic tendency of evading taxes. Many

scholars have, however, suggested that tax on the total capital employed may be considered as an alternative to the taxes on income and wealth

(e) Mix of Direct and Indirect Taxes

Composition of tax system is very important in designing the tax structure in an Islamic system. Direct tax is recommended because it falls more on the rich than on the poor. But absolute reliance on this system will be undesirable since it would be too unwieldy, unmanageable and expensive. It would also give way to evasion by a large segment of the population. Indirect tax is also recommended because it allows all persons to contribute something towards the socio-economic development of the country. This is what is demanded by the institution of *Infaq* as discussed above. However, its scope should be limited in an Islamic state because of the fact that it is regressive in character and hence would be inequitable to low income groups. Therefore, a mixture of direct and indirect taxes would appear to be the best principle of taxation for an Islamic state.

The indirect tax would fulfil the universal obligation of *Infaq* and a direct tax on higher income groups to effect equity and distributive justice. On the whole, direct tax is to be preferred to indirect tax. Note that each member of the Muslim society is required to contribute to the public and social needs in accordance with his/her abilities and resources, be they financial, or labour work, or mere prayers (*Dua*').

(f) Defence Tax

Since in a number of Muslim countries, a substantial portion of public expenditure goes to defence, it may be necessary to impose defence tax on per head basis. However, it is desirable that this tax is imposed as an additional tax without any changes in the personal taxes.

(g) Linking the Tax System with *Zakat* and Subsidy

In designing the tax structure in an Islamic economic system, one should consider not only the distribution of tax burden of the tax

payers but also its linkage with the distribution of such funds as *Zakat* and subsidy. In a sense, this is the most important and the most intricate aspect of the Islamic tax structure. Introduction of *Zakat* brings into the taxation system a concept of redefining a taxability base on total consideration of abilities of the tax payers, an ability that consists of the relative levels of both income and wealth. In Islamic economics, proper attention is given on the distributive justice. From this viewpoint, people may be grouped into three categories as: people living below poverty level, those living below subsistence, but above poverty level, and well-to-do people. Islam demands that in distributing the tax burden and the distribution of *Zakat* and subsidy justice (*adl*) and kindness (*ihsan*) will have to be maintained. The issue is discussed further in the paragraphs to follow.

(i) Below Poverty line

Those people who cannot afford to meet the basic necessities of their likes are said to be living under poverty line. These people are unable to consume the minimum calorie of 2332 units as recommended by the FAO. In Islamic terminology, they are called the '*Zakat*-deserving people'. Since they are to pay indirect taxes, this negative, or more technically, the regressive, effect should be compensated through *Zakat* and other funds meant for the poor.

(ii) Subsistence level

These people live above the poverty line as defined above but live at the subsistence level and do not qualify the Quranic condition i.e., **'They ask thee what to spend; say whatever remains surplus' [Baqara 2:219]**. That is, they do not possess any surplus income after meeting their basic necessities. Notably, these people are not *Zakat*-deserving since the value of their total assets may be somewhat above or near the *Sahib Nisab*, in the strict sense of the term. The circumstances have been nicely described by Zaman in the following way:

This happens 'due to holding indispensable valuables like jewellery, house, or consumer durables. It is very difficult to convince a destitute widow to sell a portion of 125-gram gold jewellery, which

makes her *sahib nisab* and thus disqualifies her to receive assistance from *Zakat* fund. An owner of a house valuing 10,000 Islamic Dinar would not agree to exchange his ancestral house with an ordinary low cost tenement and utilises the balance of revenue for his needs.... It would not be advisable to line up such asset owners with *Zakat*-deserving destitute who diffuse the *Zakat* budget which may generally be limited.' (Zaman 1993, p.29).

This type of people should be financed through other means from general budget. Assistance may be given in the form of subsidy of various forms. These people should not be brought under direct taxes under any circumstances.

(iii) Well-to-do people

It is presumed that these people have income above the subsistence level and have the capacity of paying direct tax even at the progressive rate. However, it should be borne in mind that the tax rate should be such that it allows the payees a comfortable margin above the subsistence level. No additional levies on personal or collective incomes are imposed on assessees whose incomes fall below the *Nisab* stipulated in *Zakat*. Double or multiple assessment of the same base should not be made in the same stipulated period as in *Zakat*. Hence such a policy is to be avoided in the case of other direct taxes.

The fiscal implication of this principle should be clearly understood. It involves the exclusion of such levies as wealth tax if assessed on the basis of *Zakat*, that is, net wealth of *Zakat* assessee and are yearly recurrent. As far as those taxes, which are leviable once, such as inheritance tax, or estate duties they are a separate category, and are assessed on a base different from the *Zakat* base. Hence, they do not fall under the purview of this principle.

REFERENCES FOR FURTHER READING[6]

1. Hasanuz Zaman (1993), 2. M. Kahf (1986)

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[6] For details, see the list of references given at the end of the Book.

PART - VI

INTERNATIONAL TRADE

'AND HOLD FAST, ALL TOGETHER, BY THE ROPE WHICH ALLAH (STRETCHES OUT FOR YOU), AND BE NOT DIVIDED AMONG YOURSELVES; AND REMEMBER WITH GRATITUDE ALLAH'S FAVOUR ON YOU; FOR YE WERE ENEMIES AND HE JOINED YOUR HEARTS IN LOVE, SO THAT BY HIS GRACE, YE BECOME BRETHREN; AND YE WERE ON THE BRINK OF THE PIT OF FIRE, AND HE SAVED YOU FROM IT, THUS ALLAH MAKE HIS SIGNS CLEAR TO YOU: THAT YE MAY BE GUIDED' [AL-IMRAN 3:103].

CHAPTER 16: COOPERATION AMONG MUSLIM COUNTRIES

Chapter 16

CO-OPERATION AMONG MUSLIM COUNTRIES[1]

[**Key concepts**: least developed countries – Muslim countries – rationale of co-operation – potential areas of co-operation – structure of production – structure of trade – direction of trade - OIC – IFTA – IPTA – NAFTA – GATT -Islamic Common Market]

Including Palestine there are now 54 countries, which are listed as members of the Organisation of the Islamic Conference (OIC). These are named as Muslim Countries (MCs), also called Islamic countries (ICs). All together, they have some 1,250 million people which constitutes about 20 per cent of the total world population. They produce about 66 per cent of the world's crude oil, 70 per cent of natural rubber, 40 per cent of jute, 50 per cent of palm oil, 80 per cent of kopek and 90 per cent of cinchona. Besides, they have huge quantities of tin, coal, iron ore, bauxite, and phosphate and they are also rich in many industrial raw materials such as cotton, cocoa, hides and skins. The oil-rich MCs possess huge surpluses of invisible funds, while others have abundance of surplus manpower, skilled and unskilled (Sadeq 1996, p. 38).

Against this background, one can not but become a bit surprised to hear that they are not only less developed industrially when compared with the other industrially developed countries of the world, but also most of them are poor and so poor that 19 (37%) of

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[1] This Chapter is based on the materials published in the Seminar proceedings *Towards an Islamic Common Market*, see Bhuyan, et al 1996. The figures quoted in this chapter are from The World Bank Development Report 1997 or as quoted in the various tables contained in the articles.

them are regarded as 'Least Developed Countries' by the World Bank classification. Herein lies the importance of an analysis of the economy of the MCs and examine the role of cooperation among them. The contents of this chapter are arranged as follows:

- Basic economic characteristics of Muslim countries
- Rationale of economic co-operation
- Potential areas of co-operation
- Institutional framework
- Problems of co-operation, and
- Some suggestions

We now proceed to discuss these issues one by one.

1. BASIC ECONOMIC CHARACTERISTICS OF MUSLIM COUNTRIES

The basic feature of the MCs is that they are dissimilar, and highly dissimilar in character. The only notable feature, which is common to all countries, is that a vast majority of their population is Muslim. In the following paragraphs are described some of the distinguishing characteristics in terms of dissimilarities of the MCs.

(a) Population

As noted above, presently all the MCs together have about 1,250 million people, but these are very inequitably distributed among the individual countries. There are countries, which have very large population, and there are countries whose population is very low. Countries with more than 100 million are Bangladesh, Pakistan and Indonesia and those with less than 1 million include the Maldives, Brunei, Bahrain, Camoros and Djibuti. Density of population also varies tremendously from one country to another. The most densely populated countries with more than 500 people per sq. km. are Bangladesh, Egypt and Bahrain. On the other extreme, very thinly populated countries having less than even 10 persons per km include

Chad, Comoros, Mali, Niger and Libya. Incidentally, the density of population in Bangladesh is 768 per sq. km. (1991) which is the highest among the Muslim countries.

(b) Per Capita Income

The MCs differ quite widely in terms of per capita income. As in 1995, the per capita GNP varied from US$180 in Chad to US$17,400 in the UAE, implying that the per capita income of the richest country is about 100 times more than that of the poorest country. Bangladesh's per capita income was US$ 240. However, in terms of per capita income the MCs can be divided into the following groups:

43%	:	Least developed
9%	:	Other low-income
25%	:	Lower middle-income
16%	:	Upper middle-income
7%	:	High income
100%	:	All MCs

(c) Growth Rate

In the similar fashion, the growth rates vary from one country to another extremely widely. For example, according to the World Bank Report 1997, the average annual growth of GNP per capita during the period 1985 to 1995 was as poor as (-) 16.3 per cent in Azerbaijan and it was as high as 6.0 per cent in Malaysia. It was 2.1 per cent for Bangladesh during the same period.

(d) Structure of Production

The structure of production of the MCs indicates a predominance of primary activities in the GDP. Industrial sector plays a minor role in these countries. Disparities still exist in the structure of production. The data as provided by the World Bank shows that out of 44, in only 4 countries (Indonesia, Malaysia, Egypt and Turkey) manufacturing activities account for 20 to 25 per cent of GDP. In as

many as 24 countries its contribution to the GDP is less than 10 per cent. The position of Bangladesh is in the last category.

(e) External Dependence

One striking feature of the MCs is their growing dependence on the external assistance. With the exception of a few oil-rich countries, gross domestic savings of these countries fall short of gross domestic investment. This implies that these countries are to depend upon foreign countries for the supply of capital. For example, during the period between 1985 and 1995 the resource gap for Gambia was 65%, for Guinea-Bassau 33% and for Lebanon 64%. During the same period the resource gap for Bangladesh was to the tune of 60%.

(f) Food Grain Deficit

Taken as a whole, the MCs are deficient in food supply. Some countries depend very heavily on the supply foreign food. These include Bangladesh, Egypt, Algeria, Saudi Arabia and Jordan. Some countries (e.g., Sierra Leone, Morocco and Tunisia) had even negative growth rates in the agricultural sector during the period under review.

(g) Structure of Trade

One important characteristic of the MCs is that they are predominantly exporters of primary products including fuel, and importers of mainly manufacture. Over 43% of countries, as in 1990, had at least 85% of their exports composed of fuel and primary commodities. Countries like Algeria, Chad, Gabon, Iran, Libya, Mali and Niger depend almost on primary exports. About 50% of the countries depend on the export of one or two or, at most, three primary commodities. Some of these countries do export manufactures, but bulk of these exports is in the in form of textiles and clothing. Countries like Bangladesh, Pakistan, Egypt and Turkey fall within this category.

(h) Direction of Trade

In trade, the flows of goods and services among the MCs have been very limited. Both exports and imports as percentage of their

total exports and imports were only around 9% in 1991. This means that 91% of their total exports and imports were directed to other countries. It is found that out of 40 MCs, the ratio of intra-Muslim trade decreased for 17 countries, increased for 18 countries and remained more or less unchanged for the rest of the 5 countries.

2. RATIONALE OF ECONOMIC CO-OPERATION

The rationale of economic co-operation among the MCs can be derived from both the **ideological** and genuine **economic** grounds. From an ideological viewpoint all Muslims of the world are supposed to belong to the same *Ummah*. They are not supposed to get divided. As the Quran categorically says:

> **'And hold fast, all together, by the rope which Allah stretches out for you, and be not divided among yourselves' [Al-Imran 3:103].**

Therefore, by religion, all Muslims are required to get united and help one another. The economic grounds for co-operation is discussed below.

First, it has already been pointed out that most of the MCs are poor: at least one-third of these countries is living below the poverty level. The traditional model of economic development has failed to raise the living standard of the poorest of the poor people and reduce the income disparity between the rich and the poor. It is believed that only the Islamic spirit and love for brotherhood can solve the problem of poverty now existing. This certainly calls for co-operation among the MCs.

Secondly, most of the OIC member countries are poor, and even the high-income oil-rich countries are industrially much less developed than their developed counterparts. It is hoped that mutual co-operation among the MCs would not only help alleviation of poverty among the poor members but also make the oil-rich countries industrially more developed.

Thirdly, There are enormous resource gaps among the MCs. On the one hand, there are countries, which have huge population and

abundant human resources, but do not have the required amount of natural resources, capital and foreign exchange. On the other hand, there are countries which have abundant natural resources, surplus capital and foreign exchange but can not make full use of them because of paucity of such productive actors as technology and skilled manpower and their narrow domestic markets. This is the main reason for which these countries can not but place their surplus resources at the disposal of industrially developed countries. Only mutual co-operation among the MCs can help these labour-abundant but capital-poor and labour-poor but capital-abundant countries make use of their resources to their mutual advantage. Among others, the mutual co-operation is expected to create complementarities in the production structures of the co-operating countries and, by expanding their base, result in the expansion of trade among them.

These are enough to justify the cause of co-operation among the MCs.

3. POTENTIAL AREAS OF CO-OPERATION

The potential areas of co-operation among the MCs can be identified against the backgrounds of factor endowments, income distribution pattern and resource flow imbalances. As many as five areas of co-operation are open to the OIC member countries as explained below.

(a) Co-Operation in Trade

Perhaps, from the viewpoint socio-economic development, the best area of co-operation lies in the trade sector. Studies show that intra-Muslim country trade is very small compared to the total trade of the MCs. As in 1991, intra-Islamic trade among the OIC member countries ranged around 8-9% of their total trade, compared to 60% for the EC, 34% for US-Canada, and 28% for the European Free Trade Association (EFTA). This simply demonstrates the vast potentialities that exist for co-operation among MCs.

Some specific examples can be cited in this regard. Trade in crude and manufactured fertilizers among the MCs is promising. The existing surplus can be used to satisfy the expected growing demand on fertilizers from the least developed countries of the Muslim world. Medical and pharmaceutical products have good prospects as major area on intra-Islamic trade with market size of $3 bn. Mutual co-operation is needed for changing the direction of trade.

(b) Co-operation in Service Industries

Apart from merchandise trade, trade in services is probably the most growing part in world trade. Service industries contributed to nearly half of the global GDP and about one-third of the developing countries' GDP in 1989 (Mandal 1996, p. 188). The most important service industries in the context of international trade include transportation, telecommunication, travel, media and business services, engineering construction, and banking and insurance. There exists good avenues for building transport and communication linkages among the MCs. Promotion and development of roads, waterways, shipping ports, airlines and telecommunication and postal systems are areas in point.

Exporting direct labour services from over-populated to oil-exporting under-populated MCs has been going on for a long time now. Scope exists for expanding the labour services from relatively poor but MCs including Bangladesh and Pakistan. What is now necessary is to develop and institutionalise the trade services among the OIC member countries.

(c) Co-operation in Agriculture

Agricultural development provides a key area for meaningful co-operation among MCs. The MCs have vast terrain of landscape providing a great potential for the expansion of agricultural production including food grains. Presently, most of the agriculture-based MCs suffer from many natural calamities including droughts, floods and cyclones. For these countries, considered individually, it is not possible to meet these problems. This requires research and

development works, which are very expensive, and hence requires collective actions. If the MCs together make attempt to carry out research, it may be possible to find out effective ways and means to deal with them.

(d) Co-operation in R&D

This is an age of science and technology. It is gathered that the MCs are lagging behind the developed countries with respect to R&D (research and development). The technologies that are available in the western world are mostly alien in character. The MCs have enormous scope for developing their own technologies according to their requirements and culture.

(e) Co-operation in Education, Sports and Culture

This is another area where tremendous scope exists for cooperation. Need for education can not be overemphasised. Unfortunately, most of the MCs are having alien education system very often against the spirit of Islam. This system must be replaced by the alternative Islamic education, The Muslims have their own traditions and cultures. This provides the area, perhaps the easiest one, of co-operation among the MCs.

4. THE INSTITUTIONAL FRAMEWORK

Promotion of co-operation among the MCs in the areas identified above will require an institutional framework. Fortunately such a framework already exists for the MCs. The OIC (Organisation of the Islamic Conference) has already been established in 1972 with it Headquarters in Jeddah. There are a large number of specialised Commissions and subsidiary organs of this Conference for the implementation of its programmes. The supreme authority of the OIC is the Conference of the Kings and Heads of State and Government that meet every three years. The Conference of Foreign Ministers that meet annually remains responsible for adoption of resolution on matters of common interest of the member countries. The Secretariat

is responsible for implementation of the resolutions and recommendations of the OIC meetings and reports about progresses and problems.

For supervising and coordinating the activities of the Conference, two specialised Commissions have been created. These are: the Standing Committee for Commercial and Economic Cooperation (COMCEC) founded in 1981 and the Islamic Commission for Economic, Cultural and Social Affairs (ICECSA) founded in 1976. A number of expert level meetings have been held under the auspices of these two commissions to deal with such matters as trade expansion, technical co-operation, development planning, transport and communication, promotion of joint ventures, labour force and social security, and the like.

There are many subsidiary organs of the OIC assigned with specific functions. For instance, IIT (Islamic Institute of Technology), Dhaka, established in 1978 to look after the issue concerning technical manpower in Islamic countries. and the Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRTCIC), Ankara, established in 1977, is engaged in the collection, evaluation and dissemination of socio-economic data of the member countries and also carries out policy-oriented research in important areas.

In addition to these organs, there are some independent members of the OIC system that have significant economic relevance to the promotion of co-operation among the MCs. Among these, the most important one is the IDB that is engaged in the financing of development projects of the member countries also in the short-term financing of their external trade. This body has established the IRTI in 1982 in order to conduct theoretical as well as conceptual research in the fields of Islamic Economics, as well as policy-oriented research in Islamic banking, development financing and matters relating the economic co-operation among member countries. The establishment of the Islamic Chamber of Commerce, Industry and Commodity Exchange (ICCICE) in Karachi is also recognised as an important

achievement of the OIC for the matters relating to the promotion of trade and commerce.

ISLAMIC COMMON MARKET

The establishment of an Islamic Common Market (ICM) has been referred to as the ultimate manifestation of the economic activities of the OIC. Discussions are going on as to how to form the ICM, what will be its coverage and other details.

Most scholars believe that because of geographical dispersions, structural diversities, and politico-ideological variations among the MCs it may not be feasible to strive to constitute an integration scheme at the *Ummatic* level. Sadeq suggests phase by phase integration of the MCs.[2] He suggests the following phases:

Preparatory phase: At the preparatory phase, economic integration may be considered at the regional neighbourhood. This is called Intra-Islamic Regional Integration. This should be based on geographical proximity, economic conditions, and political inclinations. In this phase the participating countries start negotiating to co-operate with each other in different matters, case by case. Through this phase, it is expected to make the participating countries understand the benefits they would derive if they get integrated at the global level.

First phase: Based on the experiences of the preliminary phase attempt will be made to form what is called Intra-Islamic Preferential Trade Area (IPTA). In this phase, the member countries will agree on some general principles to provide preferential treatment to each other in trade. The members will be free to have their own trade policies with non-members.

Second phase: If IPTA is successful for a reasonably long period of time, and the countries concerned about the benefits, they may decide to intensify the degree of their integration by moving from IPTA to Intra-Islamic Free Trade Area (IFTA). IFTA and IPTA are similar in concepts but are different in coverage and intensity.

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[2] For the materials of this section see Sadeq 1996, pp. 40ff.

Third phase: In this phase the MCs can start negotiating the possibility of adopting a common tariff policy towards the non-member countries. Intra-Islamic Customs Union (ICU) will be formed at this stage. Free movements of all goods with a common tariff policy towards the non-member countries will be the main characteristics of this ICU.

Fourth phase: It is at this stage that the proposed Islamic Common Market (ICM) can be formed, Economic integration at the ICU concentrates on the trade of goods only without any reference to the movement of factors across the member countries. If the ICM is established there will be free movements of goods and services as well as factors of production.

5. PROBLEMS OF CO-OPERATION

Fostering co-operation among a large group of economically dissimilar and heterogeneous countries scattered over as many as three continents is not an easy task and is bound to involve a wide range of issues. These issues may be classified into three groups. Two of these groups are internal and relate to the legal, financial, economic, procedural and structural aspects and the third one is external and relates to external environment. This section discusses some of these issues and the next suggests some remedial measures.

(a) At the Country Level

(i) At the country level, the most common problem is the lack of physical facilities that help link production sites with transhipment points. Lack of proper economic, financial, and credit facilities capable of persuading economic operators to develop intra-Islamic trade is also responsible.

(ii) There is a clear lack of political will among the Muslim leaders to activate economic co-operation among the MCs. This is reflected in the delay in the implementation of the decisions taken by different international Islamic bodies under the guidance of the OIC.

(b) At the Intra-Muslim Countries Level

(i) At the intra-Muslim countries level a major constraint is the lack of a strong sense of *Ummatic* consciousness. As we have seen that the MCs are divided into more than fifty nation states, they often fight each other causing bloodshed, and destroying each other's assets and properties. The sense of Islamic brotherhood is almost absent.

(ii) It is found that most countries attach more importance to bilateral rather than multilateral relations. This surely contradicts declarations of the Islamic Summit, which gives emphasis on the co-operation among the MCs.

(iii) Infrastructure facilities including transport and communication are inadequate in most of the MCs.

(iv) Tariffs and other barriers are widely used. This serves as constraint to the free movement of goods and services among the countries we are concerned with.

(v) Absence of financial facilities such as clearing houses, export credit guarantee and insurance coverage also prevents promotion of trade among the MCs.

(c) At the External Level

(i) In the political arena, it may be remembered that the Muslims once ruled the world, and now the alien forces are afraid of Islamic resurgence and Islamic unity. After the fall of the U.S.S.R., the West appears to consider Islam as their potential threat. Perhaps this type of threat is causing damage to the progress of the OIC.

(ii) In the economic arena, there is the hostile external economic environment of the MCs. One such hostile environment is the increasing discriminatory actions against exports from developing countries including the MCs. The growing tendency of many international organisations towards building up trade and economic blocs will eventually create a market blockade against the countries remaining the sphere of their domain. One IDB Report (1991-1992) observed that the market blockade and the establishment of super-regional markets such as EC and NAFTA would intensify the export

difficulties facing the MCs. One example will make the point clear. While intra-EC imports increased from 35% to 59% of the total EC imports between 1960 and 1990, the share of developing countries including the developing Muslim world in EC imports reduced from 19% to 8% during the same period.[3] The Report maintained that while such blocs enjoy economies of scale, they deny access to the exports of developing countries, which includes the Muslim countries too.

(iii) There is also the institutionalised obstacle to Islamic integration. GATT and later WTO established which came into being to promote free trade was often used against the integration of the Third world.

6. SOME SUGGESTIONS[4]

In section (3) we have identified the potential areas of co-operation among the MCs. Problems in connection with their implementations have also been discussed. This last section strives to offer some suggestive measures to deal with them.

(a) Methods of Co-operation in Trade

In order to materialise the potential trade co-operation, it may be necessary to go in for important but difficult decisions. First, because of the widely divergent levels of development, among the MCs it may not be possible to go in for such systems as Common Market and Customs Union at the initial stage. Rather a more selective approach providing for co-operation in specific sectors may appear to be more promising. The exact nature of the arrangement will of course depend upon, among other things, the level of economic development of the countries concerned.

Secondly, trade barriers will have to be removed. This suggestion will, however, have to be carefully administered. This is because in the situations where there are severe inequalities of income

[3] As quoted in Shakweer 1996, p. 140.

[4] This section is mainly based upon materials as seen in Bhuyan 1996, pp. 27-32.

and the less developed ones depend upon customs revenue as one of the vital sources of public revenues, the straight application of this suggestion may result in a relationship of dominance and dependence between strong and week partners. This calls for designing the trade liberalisation policy in such a manner that the relatively weak partners can also derive tangible benefits out of it. Bhuyan suggests that instead of total elimination of trade barriers, it would be advisable to go in for a selective approach to trade liberalisation such as preferential trade arrangement. An 'across to board' or 'product by product' approach whereby tariff cuts are instituted on products included in a common list specially prepared for the purpose is recommended for tariff elimination. (Bhuyan 1996, p. 28).

Thirdly, since the MCs as a whole have enough vitally important natural resources (e.g., crude oil) and huge manpower, it is advisable that joint venture collaboration in various sectors, either in the form of bilateral or multilateral, are undertaken without loss of time. The projects undertaken under this system should be mainly in the private sector, but their markets should preferably be confined to the Muslim world so that the benefits are mainly accrued to the MCs.

Fourthly, it would be beneficial if the trade liberalisation, in the way described above, is also accompanied by the free movement of labour and capital among the MCs.

Fifthly, expansion of trade among the MCs would require co-operation in research and exchange of market information, harmonisation of the procedures for documentation and customs valuation, development of transport and shipping for easy movement of freight among the MCs, and also a regional development bank for providing investment finance.

(b) Methods of Co-operation in Agriculture

The basic issues facing the agriculture-based Muslim world are: (i) natural calamities like droughts and floods; (ii) lack of access to modern inputs like appropriate irrigation technologies, chemical fertilisers, and appropriate pest control devices; and (iii) food

shortage. Given these issues, it is suggested that the MCs jointly pool their resources and do research in order to find out solutions to these problems. Regarding the food shortage, it is suggested that attempts are made to build up food stock not only at the country level but also at the global level. This is an issue that requires serious consideration of the leaders of the Muslim world.

(c) Methods of Co-operation in Trade Services

In order to derive benefits from the trade services across the MCs, the following suggestions are made: (i) for land-locked countries, provision should be made for the improvement of waterways; (ii) common ship-building and repair facilities will have to be established; (iii) an Islamic shipping line with multi-modal transport facilities should be created; (iv) air linkages among the MCs should be developed; and (v) postal and tele-communication systems will have to be developed standardising the rates and equipment.

(d) Methods of Co-operation in R & D

Some countries are engaged in doing research in such fields as agriculture, industry, genetics, biotechnology, etc. Researches done in this area are very expensive. It is, therefore, suggested that the resources made available for these R & D efforts by different MCs are pulled together and strengthen the research efforts. This is a an area where the Muslim world lagging far behind their developed partners. Hence the MCs should devote much attention to this aspect of co-operation without loss of time.

(e) Methods of Co-operation in Sports and Culture

It is learned that there are some MCs, which are well-advanced in Islamic education and culture. Immediate steps should be taken to exchange scholars among the MCs. Teachers and other scholars can be exchanged through such approaches as Memorandum of Understanding, scholarships and other forms of financial assistantships may be provided to the students and research scholars for pursuing studies in Islamic education.

Sports and culture is now regarded as one of the easiest means of co-operation among different countries. For the MCs this will have to be institutionalised. It is suggested that an institutional framework in the form of Islamic Athletics Commission, Islamic Sports Federation and Islamic Football Federation may be devised. Through these institutions annual events may be arranged in the selected countries every year. In addition to exchange of books, journal, pamphlets, newspapers and other publications may be made among the MCs. Cultural programmes may be arranged on the Islamic holy days such as Birth and Death Anniversary of the Prophet, Eid-ul fitr, Eid-ul Adha, Lailatul Miraj etc.

Above all, to make the co-operative spirit operative, it will be necessary to raise the ideological and *Ummatic* consciousness among the people of the Muslim world. If the suggestions given above are implemented the Muslim *Ummah* would emerge not only as an economically strong but also politically dominant force in the world.

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1. A. R. Bhuyan, M. S. Hussain, M. N. Islam and S. M. A. Akkas (Eds.), (1996), 2. A. H. M. Sadeq (1996).

[5] For details, see the list of references given at the end of the Book.

PART - VII

ECONOMIC DEVELOPMENT

'IN ORDER THAT IT (WEALTH) MAY NOT (MERELY) MAKE A CIRCUIT BETWEEN THE WEALTHY AMONG YOU' [HASHR 59:7].

Chapter 17

ECONOMIC DEVELOPMENT AND ISLAM

[**Key concepts:** Islamic economic development - goal-oriented and value-oriented activity – *Ibadah* - maximisation of human well-being – spiritual and material development – multi-dimensional activity – indicators of development in Islamic perspective – growth with equity – trickle down theory – Islamic principles of production priorities – survival necessities – basic needs – comforts – luxury – *Halal* and *Haram* items – poverty: material, spiritual, absolute, relative, natural, & man-made - social economic justice]

1. CONCEPT OF ISLAMIC ECONOMIC DEVELOPMENT

Economic development usually refers to a process whereby an economy's real per capita national income increases over a long period of time. More elaborately, it is looked upon as a dynamic process, involving structural changes, which produce a significant and sustained improvement in the performance of the economy, actual as well potential, measured usually in terms of per capita real income and which is spread over fairly a long period of time.

In Islamic economics, the concept of development is value-loaded. This implies that if the economic development involves production of those goods and services that affect human welfare adversely, that can not be regarded as development. Production of pork, alcohol, alien culture-oriented cinema films, etc. would have no positive values in an Islamic economy. According to Sadeq, economic growth is defined 'as a sustained growth of a right kind of output which can contribute to human welfare' (Sadeq 1991, p. 55).

More importantly, the Islamic concept of development treats the problem of economic development as an important part of a wider problem, that of human development. The primary task of Islam is to

guide human development on correct lines and in the right direction. It deals with all aspects of economic development but always in the framework of total human development. According to Mannan, 'Economic development in Islam refers ... to a process of balanced and sustained improvement in the well-being of man in his totality over a period of time. This totality embraces life on earth and life after death, involving the dual notion of accountability that influences resource allocation, its distribution and its us.' (Mannan 1989, p. 15). Khurshid Ahmad has described economic development is as 'a goal-oriented and value-realising activity, involving a confident and all-pervading participation of man and directed towards the maximisation of human well-being in all its aspects and building the strength of the *Ummah* so as to discharge in the role as God's vicegerent on earth and as 'the mid-post people'. Development would mean moral, spiritual and material development of the individual and society leading to maximum socio-economic welfare and the ultimate good of mankind' (Khurshid Ahmad 1980, p. 180).

From the above description, **the essential features of Islamic economic development** can be derived. These are shown as under:

(a) The Islamic concept of development is comprehensive in character; it includes moral, spiritual and material aspects. Development means development of human beings in all these dimensions. The moral and the material, the economic and the social, the spiritual and the physical are inseparable. The welfare Islam seeks extends beyond this present life. This dimension is missing from the contemporary concept of development.

(b) In Islamic economic development, the main focus is on man. Therefore, development means development of man and his physical and socio-cultural environment. In the conventional economics, it is the physical environment – natural and institutional – that provides the real area for developmental activities. Islam insists that the basic area of development is man, and his environment. Therefore, non-economic variables such as human attitudes, incentives, tastes and aspirations are as much policy variables as

physical resources such as land, labour and capital. This has two policy implications: **One**, the number of policy variables will be larger than the conventional economic development; and, **Two**, there will be more emphasis on the participation of the people at all levels of decision-making and plan-implementation process.

(c) Islamic economic development is a multi-dimensional activity. Islam demands that a balance between the different factors and forces be established.

(d) Conventional economic development gives emphasis on the quantitative aspect, neglecting the qualitative aspect. Islamic economic development tries to rectify this imbalance.

(e) Among the dynamic principles of social life, Islam gives particular emphasis on two. **One**, the optimal utilisation of resources that Allah has endowed to man; and, **two**, their equitable use and distribution and promotion of all human relationships, on the basis of right and justice. 'Islam commends the value of *shukr* (thankfulness to God by availing of His blessings) and '*adl* (justice) and condemns the disvalues of *kufr* (denial of God and His blessings) and *zulm* (injustice).' (Ibid. p. 180).

2. IS ISLAM AN OBSTACLE TO ECONOMIC DEVELOPMENT?

In the western world, it is normally believed that Islam is an obstacle to economic development.[1] It may not be very difficult to find even some 'Muslims Scholars' who tend to hold more or less the same view. Of the various anti-Islamic views, some are deliberate, some are innocent and some are indistinct. These are explained as under.

Firstly, one section of the writers is deliberately striving to show that Islam is an obstacle to economic development. For illustration, they are referring to Iran, which executed an Islamic Revolution under the leadership of Imam Ayatollah Khomeini. The following statement would sufficiently reflect their views.

[1] See Sutcliffe 1995.

'Though a prominent theme in Khomeini's pre-revolutionary rhetoric was the elimination of poverty and exploitation, once he rose to Iran's helm he subordinated his stated economic objectives to the general goal of restoring the centrality of Islam in public life – even to such particular objectives as eliminating the consumption of alcohol, veiling women, banning Western music, and severing Iran from its pre-Islamic heritage. After the revolution, when pressed to speed up the economic transformation, he quipped that the revolution was not made to make watermelons more plentiful (Bakhash 1989, p.16). On another occasion, he dismissed demands to concrete economic reforms on the grounds that economic well-being is worthy of the donkey (Rahnema and Nomani 1990, p.296)' (Kuran 1997, p.84).

Assuming that these statements are correctly recorded, and without knowing the backgrounds, it can still be argued that the above statements do not necessarily reflect the anti-development spirit. Obviously, by referring to 'plentiful watermelon', Khomeini actually meant luxurious living amidst wide-spread poverty in his country. Scitovosky says more or less the same thing but using different words as, 'Poverty in the midst of plenty and joyless affluence are but symptoms of a profound disorder' (Scitovosky 1976). Needless to add that, to hanker after increase in one's personal well-being without caring for the society one lives in is definitely worthy of the four-legged animals, donkey for example. In any case, the above quoted statements are given by a political leader and do not necessarily reflect the views of Islamic economists we are concerned with.

Secondly, there are Muslims who sometimes, very innocently though, tend to present Islamic tenets in such a fashion that these can easily be interpreted as 'anti-development'. In this connection, I would narrate one of my personal but practical experiences:

Given my curious interest about the virtues of *Tabligh*, I was once listening to a 'After-Maghrib' speech of an Ameer (leader) of the group in an urban mosque. In the whole speech, the speaker repeatedly underlined with great emphasis on, to quote, 'This world is nothing but a TOILET. The sooner we leave it, the better for us...We must devote at least twelve hours each day to praying'. While

digging out the Islamic literature for the book, I got hold of the reference. The author was explaining the meaning of the verse 201 of *Surah* **Baqara,** that we say after every prayer in *Munajat* i.e. **'Our Lord! Grant us good in this world, and good in the Hereafter; and save us from the chastisement of the Fire (of Hell)'**. After discussing thoroughly the interpretations given by different Islamic scholars/jurists, he remarks, 'I admit that this world and the requisites of the life are unavoidable needs, yet note that no sensible person would keep sitting in the toilet, even though one is compelled to visit the toilet....If we carefully study the *Shariah*, we will have to admit that it has prescribed a proper place for our worldly activities and religious duties. We have been commanded to devote one half of our time to the prayers, and we may spend the rest of time in our worldly pursuits, whether we devote it to rest or to earning our living...'.[2]

This is the source of confusion. To my understanding, this statement or interpretation is basically addressed to the common people who always hanker after the worldly affairs neglecting the Hereafter altogether. For the consumption of the Islamic economists, however, his concluding remark would appear to be quite reasonable. That is, 'So if we devote ourselves wholly or mainly to worldly requirements, then we are unjust and negligent. The sense of justice requires that we should be faithful to both, that is, to requisite of life as well as to the Hereafter, so that both are catered for, because Islam does not advocate withdrawal from this world. This is what is meant by the above-mentioned verse [**Baqara 2:201**]' (Ibid. p.28). After all, I always admire *Tabligh* for its many virtues such as encouragement of self-improvement and self-reliance: its members are expected to decline gifts from others while on the way of *Tablighi* works and to become more generous and more honest.

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[2] Zakariya (1990, p.28). For this the author refers to a large number of Quranic injunctions including **Bani-Israil 17:18-19; Al-Imran 3:15,152; Anam 6:32,70; Hud 11:12; Taubah 9:38** etc. However, through my inexperienced and untrained eyes, it was not possible to identify any *Ayat* that explicitly reflect the statement made above.

I have also heard many Islamic scholars quoting from *Hadiths* to prove that Islam and poverty are inseparable. I have collected the relevant *Hadith* as quoted below:

> The Prophet (pbuh) said, 'O Allah, grant me life as a poor man, cause me to die as a poor man, and resurrect me in the company of the poor'. Aysha asked him why he had said this, and he replied, 'Because they will enter Paradise forty years before the rich. Do not turn away a poor man, Aysha, even if you can give is half a date. If you love the poor and bring them near you, Aysha, Allah will bring you near Him on the Day of Resurrection.' (***Tirmidi***)

Another relevant *Hadith* is:

> The Prophet used to pray by saying, 'O Allah! I take refuge from poverty, need and humiliation' (**Bukhari**).

If we combine the first *Hadith* along with its explanation and interpretation with the second one, the Islamic view on poverty, and hence economic development become absolutely clear. That is: '**Islam hates poverty but loves the poor**'.

Thirdly, anti-development impression might have also been created by indistinct interpretation of some of the Quranic terminology. One such case can be illustrated by referring to the following *Ayat*:

> **'I created the jinn and humankind only that they might worship *(Ibadah)* Me' [Zariyat 51:56].**

What does actually the Quranic word '*Ibadah*' mean? Very popularly it means '**to pray**'. In the traditional religions (except 'Islam') the terms '*Ibadah*' and 'formal prayer' are treated as synonymous. For instance, to pray in the mosque, or temple or church. That means 'praying' is confined within the four walls of the mosque, temple or church. Perhaps from this popular belief some Muslim 'scholars' too consider these two terms as similar and by '*Ibadah*' they mean to pray in terms of *Salat, Saum, Hajj* and *Zakat.*

In truth, in Islam, this interpretation of *Ibadah* is considered to be too narrow and is unacceptable. Truly speaking, this term in Islam is very wide and comprehensive. According to the *Shariah* it means

anything and everything that satisfies Allah. It includes not only the formal prayer as mentioned above but also travelling, eating, sleeping, buying, selling, producing, helping people, and so on and so forth. Ghazzali has grouped all the activities relating to *Ibadah* into ten categories of which **striving for earning money through permitted ways has been given high place.**[3] It is said that people pray for their own welfare. It should, therefore, be clear now that, in Islam, the place of *Ibadah* is not confined within the four walls of the mosque, as some persons may appear to believe. The Prophet says, 'For me, the whole world has been turned in to a Mosque' **(Bukhari)**.

From this brief discussion, it can be concluded that *Ibadah* means the development of human beings in totality, in particular, in economic, social and moral aspects.

For enhancing one's well being in this world, there are many instructions in the Quran. Some of them are:

(1) ***'And when the prayer is ended, then disperse in the land and seek of Allah's bounty*, and remember Allah much, that ye may be successful' [Jumua 62:10].**

(2) **'Seek amidst that which Allah has given thee, the last abode, and *forget not thy portion of the present life*' [Qasas 28:77].**

Islam has never stood against economic development; it has rather encouraged and suggested ways and means to enhance the speed of development so that the Muslims become *Zakat*- payers and not *Zakat*-receivers. The Quran has emphasised the collection of *Zakat*, and not to receive it. However, the case for economic development becomes clearer from the *Hadiths* of the Prophet, who is often termed as the '**official interpreter**' of the Quran. Rather than quoting the relevant *Hadiths,* we produce below a summarised view of the Prophet on economic development as can be derived from his various *Hadiths.*[4]

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[3] For details, the readers are strongly advised to see *Islami Bishwakosh* (The Encyclopaedia of Islam in Bengali) published by the Islamic Foundation Bangladesh, 1988, vol. 4, pp. 438-443.

[4] For details and the relevant sources see Akram Khan 1989, chapter 11.

The Prophet placed a high value on the economic welfare of the people. He liked to see the Muslims well off rather than hungry. Madinah had an agrarian base and bulk of the local people was dependent on agriculture. He invited the people to develop dead lands and creed that the lands belong to those persons who develop them. Similarly he instituted many laws regarding cultivation and marketing of agricultural products. Thus, he set a stage for the development of the agricultural sector.

The Prophet gave an elaborate code for trade and commerce. A scheme was visualised in all trade activities. This was intended to end exploitation and provide congenial atmosphere for the promotion of trade and industry in the then Madinah.

It is well known that the economic resources available for economic development are limited. Realising its importance, the Prophet gave due importance on the effective utilisation of all Allah-given resources. He disliked to see even the skin of a dead animal go waste. It is of late that the economists have realised the importance of human resources for economic development. Interestingly, the Prophet realised its importance even in those days. He laid emphasis on intensive development of human resources. It is known through *Hadith* that the prophet assigned a high value on industry, efficiency and labour. Parasitic dependence on others was discouraged. He did never like idleness or beggary. He induced people to put in hard work and earn livelihood of their own. He said,' Any one of you who gathers a bundle of fuel-wood (and carries it to the *Bazaar*) on his back, is better than one who begs from anyone and he grants him or refuses (to grant) him'. The Prophet allowed the people to do business even during *Hajj* time. This was of course on the basis of the Quranic instruction: **'There is no sin upon you if you pursue Allah's bounty' [Baqara 2:198].**

Akram Khan (1989, p.214) discovered certain hints from the various *Hadiths* of Prophet regarding the planning and resource allocation. During the expedition when the ration outran the needs of the detachment, the Prophet ordered to pool all the provisions.

Thereafter he distributed these provisions equitably. Traditions like this can conveniently be made, he opined, the basis for planning of resource utilisation in the Islamic economy.

Hoarding of savings is highly discouraged in Islam. Productive investment to contribute to the realisation of the improvement of human well being is the social obligation of all Muslims. Look at the implications of the following sayings of the Prophet:

> 'Any Muslim who plants a tree or cultivates a field such that a bird or human being or an animal eats from it, this deed will be counted as an act of charity' **(Bukhari)**. This is an example of encouraging investment.
>
> 'He who sells a house (without need), but does not invest the proceeds in something similar, Allah will not bless the proceeds' ***(Al-Hadith)***. This is an example of discouraging disinvestment.

Mannan in his work as noted above has drawn our attention to another very important dimension of Islamic economic development. He opines that the income-earning and income-spending activities must generate a **social surplus**, part of which would go directly to relieve human misery. **'And those in whose wealth is a recognised right for the (needy) who asks and him who is prevented (for some reason from asking)' [Maarij 70:24-25].** The present generation must produce enough to generate a surplus to perform certain *Ibadah* such as payment of *Zakat* and *Sadaqa* to the poor, as well as for more provisions for future generations and for promoting the cause of Islam. He says,

> 'When the Quran has condemned excessive involvement in material pursuits to the neglect of moral and spiritual developments, its stress on earning one's livelihood through the efficient utilisation of one's resources has a dual significance in Islam. In an Islamic framework, one's livelihood implies that in addition to one's livelihood one must also try to make provision for those who are poor, destitute and handicapped and can not make their living for various reasons. Once this notion of income-sharing is introduced into the very concept of one's earnings at a micro level, there is a need for economic pursuits on a persistent basis at a macro level, as long as the striving force of

these economic pursuits is guided by the consideration of altruistic behaviour rather than individual acquisitiveness... In a properly run Islamic society, a higher level of material possession is expected to improve the quality of physiological and spiritual life. Seen in this context, a fine case can be made to improve the material standard of living on a persistent basis, contrary to the views expressed by some scholars' (Mannan 1989, pp, 12-13).

Perhaps against this scenario the 'Muslim jurists have unanimously held the view that the welfare of the people and relief of their hardships is the basic objective of the *Shariah*' (Chapra 1985, p. 35).

Against the above background, it can be concluded that Islam is not an obstacle to economic development. It rather helps achieve, as elaborated in the later part of this chapter, growth with equity. Perhaps Paul Streeten is right when he says, 'the important reason is that the transfer of western institutions and standards has been disappointing and, indeed, in some cases created or aggravated obstacles to development' (Streeten 1974).

3. POVERTY AND THE QURAN

(a) Conceptual Issues

'Most of the people in the world are poor, so if we knew the economies of being poor we would know much of the economics that really matters'. T.W. Schultz

In the traditional economics, poverty means lack of material goods and services. Several methods are used for measuring poverty. One popular method is 'income method'. That is, if a person possesses less than a defined income level (say, Tk. 20,000 per family per year), he is said to be poor. Calorie intake per person per day is another method. For instance, if a person (on the average) takes less than 1800 calories per day, he is poor. In general, poverty refers to state of affairs where resources are lacking to meet the basic needs not only for continued survival but also a healthy and productive life.

In Islam, human poverty embraces both material and spiritual poverty. The latter dimension is added because in Islam, 'Richness

does not lie in the abundance of worldly goods, but richness of the heart itself' (**Muslim**). In other words, a person may be rich in terms of wealth, but he may be poor when his cultural and spiritual achievements are taken into account. Islamic economics basically deals with the material poverty but does not neglect the spiritual one while prescribing policy suggestions.

In traditional economics, a distinction is often made between 'absolute' and 'relative' poverty. Absolute poverty refers to that level of poverty at which the people are unable to meet even their minimum necessities of life including food, clothing, shelter, education, and medicare. Relative poverty, on the other hand, refers to a situation where a person is poor in relation to others. This level of poverty exists even in the highly developed countries like the UK and the USA. What is important to remember is that a person who is relatively poor in (say) USA, may be regarded as quite rich in another country, (say) Bangladesh. Islamic economics recognises both these types of poverty but appears to give more emphasis on the absolute poverty as a matter of priority. Relative poverty has a special significance in Islamic economics. As one *Hadith* says, 'When one of you looks towards someone who is superior to him in property and appearance, he should look towards who is inferior to him' (**Bukhari** and **Muslim**). That is, Islam demands that an Islamic man should not always look upon those who are wealthier than him, but he should also look at those who are less wealthier than him. This would help him get rid of being greedy and at the same time encourage him to become sympathiser to his fellow brothers.

Islamic economics recognises relative poverty that is caused by the lack of inherent capacity of a person or ability to earn. What is not recognised is the poverty that is caused by institutional and non-institutional barriers to the access to basic inputs or to the job market.

(b) Quranic Views on Poverty

This section attempts to show the Quranic views on the nature and causes of poverty and its possible ways out.[5]

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[5] For details, see Irfan ul Huq 1995.

(i) Deviation from divine guidance

According to the Quran, poverty is largely caused by the man's deviation from the divine teachings [e.g. **Ma'un 107:1-7**]. In other words, it is due to the failure of mankind to translate into action divinely ordained teachings in social arena. Therefore, it calls for and insists upon the implementation of the Islamic economic injunctions including *Zakat* and law of inheritance in social affairs.

(ii) A man-made problem

The Quran views poverty not as a consequence of the lack of material resources, which are considered to be enough to meet all the needs (essentials) of all the creatures of the earth [e.g. **Tá-ha 20:118-19**], but rather as a man-made problem [e.g. **Ankabut 29:60**]. Thus it is possible to solve poverty provided that it rationally applies the socio-economic injunctions of the Quran.

(iii) Result of human irresponsibility

The existence of vulnerable section of population is understandable as it is associated with human conditions (age, sickness, handicaps, etc). But the transformation of vulnerability to poverty is largely a consequence of human irresponsibility. In other words, the Quran does not justify poverty as the natural result of vulnerability but rather a reflection of the irresponsibility of the relatively rich people [e.g. **Haqqah 69:34**].

(iv) Maldistribution of natural resources

As mentioned above, Allah has given enough resources to mankind for livelihood. In spite of this, people face poverty because they restrict the distribution or utilisation of these resources to certain groups and exclude others [e.g. **Hashr 59:7**].

(v) Attitude of the rich

According to the Quran, poverty among the general masses is primarily a result of the asocial attitude of the rich and the wealthy. It

repeatedly points out that the rich do not want to share Allah's bounty with their poor brothers [e.g. **Maarij 70:18, 20**]. It also points out that they will have to face dire consequences if their attitudes remain unchanged [e.g. **Humaja 104:1-7**].

(vi) **Attitude of the poor**

Poverty is also the result of anti-work attitude of the poor themselves. The Quran urges the people to work [e.g. **Tawbah 9:105**] and wants that Allah will never change the condition of a people unless they themselves make efforts for their improvements [e.g. **Rad 13:11**]. The Quran discards the view that poverty is the result of one's destiny and fate. Asceticism and lathergy have no place in Islam.

(vii) **Concentration of power**

The Quran views that poverty and concentration of economical and political power are highly correlated. Very often the people defying Quranic instruction [e.g. **Shura 42:38**] concentrates their power in few hands and take decisions, which generally go against the interest of the poor. Again, the Quran in numerous places urges the Muslims to distribute economic power through such institutions as *Zakat* [e.g. **Baqara 2:44**] and laws of inheritance [e.g. **Nisa 4:11**]. In general, Islam calls for land reform, monopoly control, fare wages, equal access to public services and other measures that help distribute assets, wealth and income-earning opportunities.

(viii) **Institution of *Riba***

The Quran categorically opines that the institution of *Riba* in the economic arena is greatly responsible for poverty. It urges the people to avoid this altogether [e.g. **Baqara 2:278-81**].

(ix) **Corrupt practices**

Corrupt practices of the relatively strong section of the society is also responsible for the poverty of the relatively weak section. The Quran strongly advises the people not to consume others' property

wrongfully [e.g. **Baqara 2:188**]. Elimination of corrupt practices including injustice, cheating, smuggling, black marketing, deceptive advertisement, incorrect weighing and measuring and lying about one's merchandise will help reduce poverty in the society.

4. INDICATORS OF ECONOMIC DEVELOPMENT

Perhaps because of ease of exposition and comparison, per capita GNP has been considered as the most important indicator of economic development for quite a long time. This per capita income is expressed in terms of US dollars. It was discovered only recently that mere per capita income can not be used as a measuring rod of economic development since it does not reflect the true picture of the socio-economic conditions of the people. One important drawback of this single measuring rod is that it gives no idea whatsoever about the impact of economic growth on the distribution of income and wealth. The objective of economic development has been changed. Alleviation of poverty has been accepted as the most important objective of many developing Muslim countries including Bangladesh. If this objective is accepted, definitely the indicators of development can not simply be measured by the per capita income alone. Other indicators must be considered.

The World Bank publishes a long list of indicators of development in its Annual Reports. Since most of the Muslim countries are poor, the most important indicators should reflect whether the basic need have been fulfilled. Considering the Islamic viewpoint, at least 7 indicators can be suggested for measuring the levels of economic development of Muslim countries. These are:

Food	: Calorie supplies per head
	: Calorie supply (a percentage of requirement)
Housing	: Average number of persons per room
Health	: Life expectancy at birth
	: Number of hospital beds per thousand persons
	: Infant mortality rate (per 1000 live births)

	:	Percentage of population with access to sanitation facilities: Percentage of population with access to potable water
Education	:	Adult literacy rate (male and female separately)
	:	School enrolment as a percentage of population in relevant age groups
Poverty	:	Percentage of people deserving *Zakat*
	:	Percentage of people living below poverty level
Distribution	:	Percentage share of income or consumption – lowest 20%
	:	Percentage share of income or consumption – highest 10%
Environment	:	Nationally protected forest area (as % of total land area)
	:	Rate of annual deforestation of forest area (% change)

It may be noticed that the indicators mentioned under 'poverty' above are the ones that are particularly relevant for the Islamic countries.

5. DEVELOPMENT PRIORITIES

Two issues are involved in connection with the determination of development priorities. One, it will have to be seen whether growth and equity are compatible and can be considered as a strategy for Islamic economic development. Two, it will be necessary to see whether there is any guideline for making a choice regarding product mix for an Islamic economic development.

(a) Growth and Equity

We begin with the first issue. In the conventional economics, it is believed that growth and equity can not go together. Which is to be aimed at, then? The importance of both is not overlooked. The argument is that if growth is given preference over the equity issue, the later could be achieved automatically at some later stage. The explanation of this theory is that if inequality of income exists in the society, the people with higher income will be able to save more and

hence more investment will take place. There would also be a transfer of income from the poor persons having lower Marginal Propensity to Save to the upper section having higher propensity to save. Once economic development gets momentum, the portion of the surplus income thus generated would be automatically transferred to the poorer sector of the economy. This theory is also called the Trickle Down Theory in the conventional economics arena. This theory was very popular during the sixties and the early seventies.

This theory has been seriously criticised. Even the conventional economists believe that the Trickle Down Theory does not work. The counter arguments are: first, the belief that the upper income group will save more and invest more has not come true. Rather, empirical results have demonstrated that these people when their incomes get very high do not normally save. They use their surplus money for buying luxury goods and spend mostly for imported luxury goods. Second, on the other side of the picture the poorer section become so poor that they can not maintain their health. This poor heath produces adverse impact on their productive capacity so that the productivity gets decreased. In other words, the whole Trickle Down Theory has miserably failed.

It is generally believed that, in Islamic economics, equity is given preference over the growth .The truth is far from that. In effect, in Islamic economics, there is actually no choice between growth and equity: both are required to be achieved simultaneously.

In Islamic economics, there is a built-in mechanism for the simultaneous achievement of both growth and equity. An Islamic economic man would always strive to improve his economic well being:

> **'And when the prayer is ended, then disperse in the land and seek of Allah's bounty, and remember Allah much, that ye may be successful' [Jumua 62:10]**; and, again, **'In order that it (wealth) may not (merely) make a circuit between the wealthy among you' [Hashr 59:7].**

The first injunction tells the people to increase their incomes and the second tells them to become cautious so that increased income

does not circulate among the rich people of the society only. Thus both growth and equity are to be maintained in the Islamic society. There are of course provisions for appropriate institutional framework for materialising these apparently contradictory strategies.

Sadeq in his study *Economic Growth in an Islamic Economy* has demonstrated with a hypothetical example that it is possible to achieve both growth and equity simultaneously under the Islamic system. This is illustrated thus:

Table 1
Compatibility of Growth and Equity Under an Islamic Economic System
(A Hypothetical Example)

Total Investment	Total Profits	Marginal Efficiency of Capital	Distribution of Profit Under Interest-based System		Distribution of Profit Under *Mudaraba* System	
			Share of the Contributor of Capital	Share of Entrepreneur	Share of Contributor of Capital	Share of Entrepreneur
5000	520	-	50	470	312.0	208.0
6000	550	30	60	490	330.0	220.0
7000	570	20	70	500	342.0	228.0
8000	585	15	80	505	351.0	234.0
9000	595	10	90	505	357.0	238.0
10000	603	8	100	503	361.8	241.2
11000	608	5	110	498	364.8	243.2
12000	611	3	120	491	366.6	244.4
13000	613	2	130	483	367.8	245.2
14000	613	0	140	473	367.8	245.2

Source: Original from Sadeq 1991 (Extended).

Let us assume that for an Islamic society the pre-agreed profit ratio between a *Mudaraba* entrepreneur and the contributor of capital is 60:40 and for a conventional society client borrows money from the bank and the rate of interest is Tk 10 for Tk 1,000 per project period. It is also assumed that the project life is three months (meant for trading). As illustrated in Table 1, an entrepreneur under the

conventional system can invest up to Tk 9,000, since marginal efficiency of capital equals interest payment at this level of investment. That is, when the entrepreneur adds Tk 1,000 to previous investment of Tk 8,000, he earns Tk 10 as profit, which he has to pay entirely to the financier leaving nothing for himself. His total profit after interest payment is Tk 505 (595-90) when Tk 9,000 is invested. If he invests Tk 8,000 instead, he still earns Tk 505 (585-80). Therefore, it will be less risky for the entrepreneur to invest Tk 8,000 than of Tk 9,000.

On the other hand, an entrepreneur under an Islamic financial system can continue investment profitably beyond Tk 9,000, since he keeps on receiving positive profits up to the investment of Tk 13,000. He even increases investment up to Tk 14,000 without risk, since risk is borne by contributors of capital (here, the bank), although net gain from the additional investment will be zero.

Let us now assume that the capital's share is increased from 40 to 50 per cent for more equitable distribution of profit under this changed circumstance. The entrepreneur can still continue investment gainfully until the profit is zero at which investment is Tk 13,000 or even up to Tk 14,000 since marginal investment does not add to losses. On the other hand, if the interest is increased from 10 to 15 per cent in Riba-based economy, investment will fall from Tk 9,000 to Tk 8,000. This shows that a higher level of equity is not incompatible with growth since changes in profit ratios do not reduce investment under an Islamic financial system.

Mannan in his thought-provoking book *Economic Development and Social Peace*, has provided a new, and a very interesting, dimension of the issue of development and distribution. Western economists, including some Muslim ones, tend to treat development and distribution separately. They strive to resolve the apparent conflict by saying that Islam encourages development with social justice. To this Mannan provides the view that 'the key thrust of economic development in Islam lies not in the integration of development and social justice via distribution, nor in viewing development with social justice as an adjustment, but in treating

distributive considerations as the fundamental basis for the allocation of resources – both human and non-human, their use and maintenance' (Mannan 1989, p. 13). This concept is very crucial for understanding Islamic concept of economic development.

Distribution should precede allocation decision. In other words, it should influence priority in the production of goods and services and as such serve as an indicator to the consumption package in an Islamic framework. Once this dynamic interplay between distribution and productive considerations is understood, the so-called distinction between development, growth and distribution is blended and blurred. Viewed from this perspective, equity consideration may very well be seen as a positive moral stimulus to increased productivity and output. This would enable the Islamic economic man to perform his family, intra-family and community obligations in more effective way. Thus, in an Islamic society, equity considerations should for all practical purposes motivate economic development and social change. Mannan concludes, 'Unlike in the secular framework, these equity considerations are not the off-shoot of social pressure, stress and tension of the society, but they proceed directly from moral and spiritual necessity as perceived by the Islamic law' (Ibid., p. 13).

(b) Production Priorities

'Muslim jurists have unanimously held the view that the welfare of the people and relief of their hardships is the basic objective of the *Shariah*' (Chapra 1985, p. 35). Therefore, in Islamic economics, one is not allowed to produce any commodity of any quantity without its welfare implications. There are at least three principles, which can guide the choice of product mix in an Islamic economic society. These are:

(i) Principles of product mix

Shariah restrictions: According to the Quran, **'O ye who believe! Strong drink and games of chance and idols and divining arrows are only an infamy of Satan's handiwork. Leave it aside in**

order that ye may succeed' [Maida 5:90] and **'He hath forbidden you only carrion, and blood, and swine-flesh, and that which has been immolated to (the name of) any other than Allah ...'** [Baqara 2:173]. The internal message of these instructions is that the people must avoid production of those goods and services, which adversely affect their physical or moral well being.

Level of economic development: If the level of economic development is quite high or it has reached the stage of, say, 'high mass consumption', the product mix of the society may be left to the market forces. Otherwise certain restrictions will have to be put on the choice of the product mix considering the interest of the poor.

Degree of inequality: The third criterion is the degree of inequality prevailing in the society concerned. If in any society, the level of economic development is quite high but characterised by very high degree of inequality, absolute reliance on market forces will not help increase the economic welfare of the general people. In this situation state interference would be necessary.

It is to be concluded that in an Islamic society, appropriate product mix can only be achieved when the above three principles are applied simultaneously. We now proceed to draw a picture of product mix appropriate for an Islamic society.

(ii) Hierarchy of product mix

It is found that the Islamic economists prefer to present the produce mix in descending order of the hierarchy of needs. The nature of classification is of course is not uniform among the Islamic scholars. According to the author, the best classification of various needs for the goods and services can be stated as follows.

Survival necessities: Its status is given the highest position in Islamic society. This necessity corresponds to *daruriah* and refers to those goods and services, which are needed for survival. These are in a sense life saving, without which the person will simply die. Under this circumstance, the people are permitted to produce and consume even prohibited goods, of course to the extent necessary for survival:

'.... **He hath explained to you in detail what is forbidden to you - except under compulsion**: of necessity ...'[**Anam 6:119**].

Basic needs: After life saving, there comes the question of basic need which refers to those goods and services without which life becomes very hard but its shortage does not cause immediate death. These include such things as food, clothing, shelter, basic education, and basic health services. One of the basic objectives of an Islamic state is to provide these basic needs for each and every citizen of the country. In the economic literature, the people who are unable to meet the basic needs are said to be living below poverty line. Under normal circumstances, the highest production priority would be given to the production of these goods and services.

Comforts: The need for the production of comforts comes only after the fulfilment of basic goods. The items of comforts would vary according to socio-economic circumstances of the people and also environmental conditions prevailing in the country. For instance for a country like Bangladesh air-conditioning would be considered a luxary beyond comfort, but in a hot country like Saudi Arabia, this would be included in the list of comfort items. However, these refer to those items which make life a bit comfortable and to some extent decent. Good dress, furniture, cars for busy doctors, fans and so on. As these items are directly related to the productivity of the people, an Islamic country would assign high priority to the production of these goods and services.

Luxury: These items go beyond the list of items producing comforts for the human life. This again depends upon the stage of development of society concerned. For a country like Bangladesh luxury items would include air-conditioning, motor cars, prestigious furniture, and the like.

In Islamic economic society production of luxury goods is not prohibited but are highly discouraged, particularly under the circumstances where a sizeable section of the total population live in below poverty line. An Islamic government will consider the socio-economic status of the general masses before taking the decision of

giving any importance to the production of luxury goods within the society, because Allah has said in the Quran: '.... **But waste not by excess: for Allah loveth not the wasters**' [**Anam 6:141**].

Haram items: By definition, an Islamic society will not go in for producing any commodity that is harmful to the mankind and is prohibited by the *Shariah*. These items would include pork, alcoholic beverages, alien cinema films, and the like.

It may be concluded by saying that an Islamic country will fix production priorities in the descending order of the hierarchy of needs among the permitted goods and services.

6. THE ROLE OF GOVERNMENT IN ISLAMIC ECONOMIC DEVELOPMENT

The role of government in Islamic economic development is basically a function of goals it wants to achieve.[6] The ultimate objectives of an Islamic government are to realise both the material and spiritual developments of the inmates of the society. The principles on the basis of which these objectives are realised are democracy and welfare of the people. Both these principles owe their origins to the Quran and the *Sunnah*. The Quran says, '**And consult them in affairs**' [**Al-Imran 3:159**]. This clearly implies that an Islamic government will have to run all affairs in consultation with the Ummah. The welfare function of the Islamic government is also stressed in the Quran in several places. For example, '**Serve your Lord and do good that you have welfare (falah)' [Hajj 22:77]**. The Quranic message is also reflected in the sayings and doings of the Prophet. Thus, 'Any ruler who is responsible for the affairs of the Muslims but does not strive sincerely for their well-being will not enter Paradise with them' (**Muslim**). This welfare function refers to both the material and heavenly welfare.

With this background we now discuss the role of government in an Islamic economy.

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[6] These goals are discussed in the next chapter.

(a) Eradication of Poverty

'Poverty leads to disbelief' **(Al-Hadith)**. Undoubtedly, poverty is one of the main reasons which has kept away a large section of the Muslims from the understanding of the fundamental message of Islam, in accepting and in making efforts to implement it. It is so disturbing that they have no time to think of the philosophy of Islam. It is, therefore, one of the prime responsibilities of the Islamic government to make all out effort to eradicate poverty and provide the basic needs of all the citizens of the society irrespective of their age, sex, race, colour or religion.

(b) Full Utilisation of All Economic Resources

An Islamic government considers all economic resources as a trust from Allah, and considers it as one of its moral obligations (as a trustee) to employ these resources efficiently so that it can serve the purpose of the trust which is the welfare of all human beings of the country. Since the economic resources available for economic development are always considered to be scarce, the Islamic government does not leave the essential function of their allocation to the free play of the market forces. It plays a dominant role and consciously contributes towards the attainment of the desired goal through rational planning and building the necessary physical and social infrastructure. Here the emphasis on planning does not mean that the government will resort to unscrupulous control of the private sector. It is rather expected to play an active role in determining priorities and guiding or channelling the scarce economic resources in the light of those priorities. The expenditure on the physical and social infrastructures, which are to be the life-blood of economic development, are generally very high but their returns are generally very low. It is, therefore, quite natural that the Islamic government needs to play an active role in this respect.

Apart from financial resources, an Islamic government gives particular emphasis on the utilisation of the un- and under-employed human resources. For this, among others, it is required that the

economic capabilities of the people will have to be strengthened. The Quran says, '**Against them make ready your strength to the utmost of your power ----'[Anfal 8:60]**. While interpreting this verse Chapra opines that 'The significance of 'strength' here need not be confined to military strength. It could also be implied to refer to economic strength which, among others, lies at the root of military strength' (Chapra 1980, p.151). One area of economic strength is the provision of social capital. In this respect, the case for education is obvious. According to the Prophet, 'acquisition of knowledge is obligatory for every Muslim' (**Al-Hadith**). Another area is public health. 'A strong Muslim is better and beloved before Allah than a weak one' (**Ibn Majah**) and 'cleanliness is half of faith' **(Muslim).** Therefore, an Islamic government will play an important role in providing basic education and health services to the mass.

(c) Collection of *Zakat*

In *Ayat* 60 of *Sura Tauba* of the Quran, it has been categorically mentioned that a portion of *Zakat* money collected has to be spent for the expenses of the *Zakat* collectors. This means that the *Zakat* will have to be collected from those whose incomes are above *Nisab* (i.e. the level of income above which payment of *Zakat* becomes due). There is a consensus among jurists that collection and disbursement of *Zakat* is essentially the responsibility of an Islamic government. In effect, this was the practice during the days of the Prophet and of the first two Caliphs, Abu Bakr and Umar. An Islamic government will, therefore, play an important role in collecting and distributing *Zakat* in accordance with the Quran and the *Sunnah*. In effect, it is one of the means through an Islamic government strives to make help to the poor and needy.

(d) Social and Economic Justice

An Islamic government plays an unparalleled role in maintaining social and economic justice in the society. This has several facets. It helps secure the lawful rights of the working class

people and takes appropriate steps in this regard. A big section of the society is engaged in agriculture, industry and business organisations as workers and employees. In most cases good relationship is not maintained. The workers do not get sufficient wages to maintain a minimum living standard. They are often deprived of having minimum wages given the type of work they are required to perform. The women workers are specially deprived in the matters of rightful wages. In many factories and shops the workers are forced to work for more than 12 hours a day. Sometimes because of their minor faults, they are discharged. They are not given regular bonuses they deserve. Most of the workers in the private firms are to work under unhealthy environment. Lack of security is always a complaint from these workers. An Islamic government, can not ignore these social hazards. The Prophet says:

> 'He whom Allah has made an administrator over the affairs of Muslims but remains indifferent to their needs and their poverty, Allah will also be indifferent to his needs and poverty' **(Abu Daud).**

> 'Your employees are your brethren whom Allah has made your subordinates. So he, who has his brother under him, let him feed with what he feeds himself and clothe him with what he clothes himself and burdens him with what overpowers him. If you do so then help him.' **(Bukhari).**[7]

On the basis of this teaching, it is expected that the Islamic government will play an effective role in fixing minimum wages and maximum working hours, in creating appropriate working conditions, enforcement of precautionary measures against industrial hazards, and in adopting technological innovations for reducing hardships of the workers.

(e) Law & Order and National Defence

To maintain law and order within the country is a universally recognised responsibility of the government. An Islamic government

[7] In this transliteration the word 'slaves' has been replaced by 'employees'. Therefore, the relationship between 'Employer-employee' would be expected to be much better than what is implied in the *Hadith.*

will not protect individual properties that have been earned through illegal means.• This government will play an active role in recovering this type of wealth and return it to its genuine owners or to deposit it to the state exchequer.

Another sacred duty of an Islamic government (like any other recognised government) is to protect the country from external aggression. It dose not, however, transgress the limit. This role of the Islamic government directly owes its origin to the Quran: **'And fight in the way of Allah against those who fight against you, but do not transgress limits for Allah loves not the transgressors' [Baqara 2:190].**

(f) International Relations

An Islamic government plays an important role in maintaining and promoting international understanding and peace with rest of the countries of the world, in general, and with the Muslim *Ummah*, in particular. If resources permit, an Islamic state will provide assistance to relieve hardship and promote growth and accelerated development in the relatively poor countries. The guiding principles would include: one, to co-operate in all matters contributing to 'righteousness' and 'piety' and to refrain from co-operating in 'aggression' and 'sin' **[Al-Maida 5:3],** and two, to work positively for the welfare of mankind because it is the family of Allah **(Mishkat).**

REFERENCES FOR FURTHER READING[8]

1. M. Akram Khan (1989), 2. Khurshid Ahmad (1980), 3. M. A. Mannan (1989), 4. A. H. M. Sadeq (1991).

[8] For details, see the list of references given at the end of the Book.

Chapter 18

GOALS AND STRATEGIES OF DEVELOPMENT IN ISLAM

[**Key concepts:** improvement of quality of life – Allah-gifted resources – inflation – moral uplift – Islamic brotherhood – total human development – balanced development – useful production in Islam – export substitution – Islamic technology – distributive and redistributive justice – functional distribution – distribution of personal income]

Having discussed the basic conceptual issues relating to Islamic economic development, the present chapter attempts to identify the goals and strategies of development in an Islamic perspective.

1. GOALS OF ISLAMIC ECONOMIC DEVELOPMENT

We begin with the goals. There are well-defined goals of Islamic economic development. At the first sight, one may find these goals similar to those of the modern traditional economies: there are, however, genuine differences. These differences actually lie in the emphasis. Some of the crucial goals of socio-economic development under an Islamic system are discussed as under.

(a) Improvement of Quality of Life

The overall goal of Islamic economic development is to improve the quality of life of the people living in the country. This quality of life refers to both **material** and **moral** aspects of life. The emphasis is on the balanced development of the material and spiritual aspects as distinguished from the traditional capitalistic system. Being

the vicegerent of Allah, the Islamic economic men can not but aim at materialising this goal on top priority basis.

This goal calls for a high priority for at least in the three areas as:

- Employment creation, with particular emphasis on self-employment;
- An effective and broad-based system of social security, assuring the basic necessities of life to all those who are unable to undertake gainful employment; and
- Equitable distribution of income and wealth. There should be an active income policy directed towards raising the income level of the lowest income groups, and reducing the disparity between the haves and have-nots.

(b) Fulfilment of Basic Needs

For material development of the people, fulfilment of basic needs is very important. These include food, clothing, shelter, medical care, and, education for all humans. In an Islamic society, if the individual households become unable to meet their basic needs, then it becomes the responsibility of the state to help them either through transfer payments or through other means.

Question may be raised about the exact amount of different things that would constitute the 'basic needs' or 'essentials'. It should be absolutely clear that in Islamic economics no attempt is made to quantify this. It depends upon the level of development, the physical environment and a host of other circumstances. It may be of some interest to have some practical idea from the Prophet's sayings. In one occasion, one well-known *Sahabi*, asked the Prophet as to when and under what circumstances he can ask for help. The Prophet replied by saying that one can ask for help under three circumstances only. First, if one has incurred debt on behalf of other people. Second, when a person has fallen victim to a calamity which destroys his wealth. Third, when a person is so poor that three persons from his own neighbourhood say that he deserves help. It is actually the responsibility of the society or the government to define, given the time and place and the prevailing circumstances, the level of poverty which permits a person to ask for help.

(c) Full Utilisation of all Resources

This is another important goal of economic development in Islam. This must be because in Islam, by Quranic injunction, all resources between the earth and the heaven belong to Allah and as vicegerents of Allah men have no authority either to under-utilise or to misutilise any of His resource. Therefore, the basic aim of the Islamic economic development is to utilise fully and efficiently all the Allah-gifted resources.

Islamic economic development puts very high priority on the development of human resource. This includes the inculcation of correct attitudes and aspirations, development of character and personality, education and training producing skills needed for different activities, promotion of knowledge and research, etc.

(d) Justice and Equitable Distribution

In contrast to conventional economic development, Islam puts the highest emphasis on the socio-economic justice and equitable distribution of income and wealth. There are numerous injunctions in the Quran and the *Hadiths* to materialise this goal. It may be noted that attempts are made by the traditional governments to do justice and reduce inequalities of income between the rich and the poor, but these attempts are only temporary and suffers from the lack of sustainability. In Islam, there are built-in mechanisms through which this can be materialised. Examples include *Zakat* and *Sadaqa.*[1]

(e) Control of Inflation

Inflation is a situation 'when too much money chases too few goods.' This is a symptom of disequilibrium and is not compatible with Islamic economic development. As Chapra has very nicely pointed out, 'Inflation implies that money is unable to serve as a just and honest unit of account. It makes money an inequitable standard of deferred payments and an untrustworthy store of value......It tends to pervert values, rewarding speculation (discouraged by Islam) and

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[1] This point is elaborated in the last section of this chapter.

intensifying inequalities of income (condemned in Islam)' (Chapra 1985, pp. 37-38). It is, therefore, considered obligatory on the part of the Islamic government to keep the rate of inflation under full control and resort to healthy monetary, fiscal and income policies.

2. DEVELOPMENT STRATEGIES IN ISLAM

Goals as discussed above can not be realised without appropriate strategy. It is here that Islam has a clear advantage both over the capitalistic system and on the socialistic system. Some of the important strategies are discussed below.

(a) Emphasis on Moral Uplift

> **'Do not acquire wealth from each other wrongfully...' [Baqara 2:188].**
>
> 'Earning a lawful livelihood is obligatory upon every Muslim' **(Al-Hadith).**

Perhaps the most important strategy for attaining the goals of Islamic economic development as discussed above is the integration of material and spiritual aspects of life in order to bring about a moral uplift of the human being and the society in which he lives in. In effect, Islam does not make any distinction between these two aspects of life. Interestingly, all worldly activities may automatically bring out the heavenly benefits provided these are performed in accordance with the tenets of Islam. Chapra has very nicely described this issue as: 'All human effort whether for 'economic', 'social', 'educational', or 'scientific', goals is spiritual in character as long as it conforms to the value system of Islam. Working hard for the material well-being of one's own self, family and society is as spiritual as the offering of prayers, provided that the material effort is guided by spiritual values' (Chapra 1985, p. 46).

(b) Emphasis on Brotherhood of Mankind

One of the goals of Islamic economic development is equitable distribution of income and wealth. **'And those in whose wealth is a recognised right for the (needy) who asks and him who**

is prevented (for some reason from asking)' [Maarij 70:24-25]. This type of objective can not be fully realised unless and until we recognise the universal brotherhood of mankind so much emphasised in Islam. Therefore, a belief in the brotherhood of mankind is regarded as one of the fundamental strategies of economic development in Islam. This will come true when we believe in the Oneness of Allah to Whom we are all accountable in the Day of Judgment.

(c) Emphasis on Total Human Development

Islam emphasises human development in its totality. It not only emphasises material development but also moral and spiritual development. Islamic pattern of development is conditioned by the extent on the appropriateness of investment in human capital. According to Mannan (1984, p. 401), education output is a complex social product. It may be considered as an investment for:

- raising productivity of labour;
- providing personal satisfaction for both parents and children;
- promoting national identity and forming an informed electorate;
- transforming of a rural society into an egalitarian society; and
- Influencing attitudes, norms and values or economic behaviour of the people.

This composite nature of educational product aiming at total human development for preparation of life is hardly reflected in the emphasis of the educational system in the third world countries including the Muslim ones. Mannan maintains that the schools become irrelevant in most cases as 'it induces alienation and de-Islamisation, making one foreigner within one's own country and culture.' (Ibid, p. 402). Therefore, the existing education system needs reforms and change. The following suggestions have been made:

First, there should be equitable distribution of educational resources. In the developing Muslim world this would mean a greater

allocation of resources to mass literacy, primary education and adult education programmes.

Second, formal schooling may be considered rather costly in the developing countries for many years to come. It would, therefore, be advisable to give more emphasis on the non-formal education.

Third, it is highly necessary that the curriculums should be modified and recognised all levels of the educational cadre. Emphasis should be put on the closer link between the informal sector and its orientation towards rural development and self-employment.

Fourth, labour market should be reoriented so that it becomes possible to create employment through non-formal education and on-the-job training. This would obviously de-emphasise the importance of higher education.

Fifth, it will be necessary to review the aims and objectives of education in an Islamic perspective.

(d) Emphasis on Consultation

Emphasis on consultation (*Shura*) directly owes its origin to the Quran, i.e. [**Shuara 42:38**]. According to Islamic jurists (e.g. Ibn Taymiyyah), this Islamic development strategy is not an option, but an obligation. Chapra opines that the consultation required is not of the 'cosmetic kind, to rubber-stamp decisions made by the rulers'. There should be a free, unhindered and fearless discussion of development issues related economic well-being within the framework of the *Shariah*. (Chapra 1992, p.243). Maududi adds that the institution of consultation demands widest possible participation of the people in the affairs of the state, either directly or through representatives. (Maududi 1976, p.37).

(e) Emphasis on Balanced Development

This strategy owes its origin to the Quran. It says, '**And in the earth We have spread out (like a carpet); set thereon mountains firm and immovable; and produced therein all kinds of things in due balance' [Hijr 15:19]**. This strategy refers to balanced and

harmonious development of different regions within a country and of the different sectors of society and the economy. Decentralisation of the economy and balanced development of all regions of the country is only a demand for justice, but is also essential for rapid economic development of the country concerned. This strategy when implemented would not only remedy economic dualism from which most Muslim countries suffer but would also lead to greater integration within each country.

(f) Emphasis on Useful Production

While meeting the demand of the societies, the Islamic economic development will be concerned about the correct product-mix. Production would not mean production of anything or everything that may have a demand or the rich may be able to buy. Production would be concerned with things that are useful for man in accordance with the norms of Islam. **'Say: 'Not equal are things that are bad and things that are good, even though the abundance of the bad may dazzle thee' [Maida 5:100].** The three priority areas of production would be as follows:

- Abundant production and supply of food and basic items of necessity (including construction materials) at reasonably cheap prices;
- Defence requirements of the Muslim world; and
- Self-sufficiency in the production of capital goods.

(g) Emphasis on Distribution as the Basis for Resource Allocation

Conventional economists tend to treat development and distribution separately. Normally, this conflict is resolved by saying that Islam encourages development with social justice. Mannan adds a new dimension to it. According to him, 'The key thrust of economic development in Islam lies not in the integration of development and social justice via distribution, nor in viewing development with social justice as an adjustment, but in treating distributive consideration as the fundamental basis for allocation of resources – both human and

non-human, their use and maintenance' (Mannan 1989, p.16). This emphasis is said to be very crucial in understanding the concept of Islamic economic development.[2]

(h) Emphasis on Export Substitution

One of the development strategies of most of the developing countries is to emphasize import substitution industries. This is based upon the belief that if the goods that are imported can be produced at home, this would save foreign exchange which can be used for some other purposes for which no substitution is possible. However, if the amount of foreign exchange expenditure required for importing the capital goods needed for the production of import substitution industries exceeds the foreign exchange saved due to the reduction of the quantity of the imported goods, then this type of industries will have rather negative impact on the earnings of the foreign exchange.

Apart from this purely economic argument against import substitution industries, there is another argument for this from the viewpoint of Islamic economics. Islam emphasises the equitable distribution of income. If import substitution industries is accepted as a strategy, then it is apprehended that the distribution principle will get affected. The explanation is simple. The poor countries normally import non-agricultural goods and export agricultural goods. If import substitution industries are established this automatically mean that the country is emphasizing on the foreign goods at the cost of the agricultural sector. If, on the other hand, export substitution industries are established this would mean that more and more agricultural and agro-based industrial goods would be produced. This would lead to increase in employment and income of the rural people and hence the income disparity that exists between rural and urban sectors would tend to decline.

This above strategy would of course, among other things, require a package of supportive policies including changes in the

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[2] See the last section of this chapter for a discussion on distributive justice in Islam.

pattern of allocation of resources, imposition of appropriate productive tariff and taxation, introduction of sound wage, income and pricing policies and manipulation of monetary policies.

(i) Emphasis on Islamic Technology

One of the commonest mistakes people often make is that the transfer of technology, its development and use are **value-free.** Tools are considered as non-human in character. This is not at all true. Socio-cultural circumstances and tools can not be separated. For instance, the type basin (or urinal) one finds in the Western countries is very much associated with their culture and traditions. The Muslims do need them but of different shape so that they can be used not only for washing hands and face but also for washing their legs comfortably. This is particularly needed at the time of making ablution (*Adu).* The tools which are associated with Muslim culture and traditions are called **'Islamic technology'.**

Islamic technology will have other distinguishing characteristics. These may resemble, to a large degree, the 'intermediate technology' or 'small-scale technology' as commonly understood in the conventional economics. Some of the important characteristics are: the technology should be suitable to the local people; it should make maximum utilization of the local labour force; and, above all, it would reflect the values and norms of Islam. In the words of Schumacher 'small is beautiful'.

The term Islamic technology would also imply the evolution of indigenous technology, suited to the local conditions . 'The development process would become self-sustained only when we become not only independent of foreign aid, but when after mastering the technology that has grown in a different economic and cultural environment we are able to internalise the process of technological creativity and begin to produce technology that bears the stamp of our distinctness'. (Khurshid Ahmad 1980, p. 182). This would of course call for a high priority for research and development and a new spirit to face the challenges of the 21st century.

(j) Emphasis on Rural Development

'Priority to agriculture, funds to industry and urban infrastructure' (Lipton, 1977) has been the development strategy of the developing countries including the Muslim ones. For instance, in Bangladesh, having noticed the contribution of the agricultural sector, the GOB has always said that it will give top most priory to the agricultural sector. But while allocating resources, this intention has never been remembered. For example, in 1976-77, 29.7% of the total planned allocation was made to the agricultural sector. This percentage came down to 27.7 in 1978-79 and 27.1 during the last five-year plan. This type of trend has created an intolerable problem of urban unemployment resulting from internal migration from rural to urban areas causing social disequilibrium and moral decay.

Islam's emphasis on equitable distribution of income and wealth demands that this trend be reversed. Islamic approaches to development puts emphasis on the development of infrastructure in the rural areas and build up agro-based industries so that the migration of the people from the rural areas to urban areas gets reversed.

(k) Emphasis on Group

The Quran says, **'Help ye one another in righteousness and pious duty' [Maida 5:2]**. The economic implication of these Quranic dictates is, among others, that 'stress is to be given on the use of the technique of 'cooperative forces' in achieving equilibrium in different sectors of the economy' (Mannan 1984, p.36). Stated in another way, cooperation or group approach should be treated as an important strategy of socio-economic development in an Islamic society. Given the experiences of Bangladesh, this group approach to development should be largely voluntary in nature. Informal co-operative is expected to be more successful than formal cooperative.

(l) Emphasis on Women

Islam is a universal religion. The Quran says, **'Their reward according to the best of their actions. Whoever works righteousness, man or woman, and has Faith, verily to him will We give a new life, a life that is good and pure.' [Nahl 16:96-97]**.

One World Bank study (1981) shows that a great majority of the world's illiterate is women. This is more so in the third world countries. Muslim countries are no exception. In these countries the education bias towards man is most pronounced. The same world institution suggests that educating girls may be one of the best investments a country can make in future economic growth and welfare. Even if the girls never enter the labour force, they can make tremendous contributions to the socio-economic development of the country in question. In the health sector, studies in Bangladesh and other countries show that the children are less likely to die, if their mothers are educated, even allowing for differences in family income. In nutrition, household surveys made in Brazil show that for any given level of income, families were better fed when their mothers have higher education. Again, it is almost universally true that the education delays marriage for women.

Islam fully recognizes the role of women in the family and in the society. The Quran categorically declares that **'To men is allotted what they earn and to women what they earn'** [Nisa 4:32]. This means that women will be held responsible for their deeds as much as their male counterparts. Therefore, if women are to make their contributions to national development, access to quality education is essential; and, hence, one of the development strategies of the Muslim countries should be to discard the bias towards men and allocate larger resources for women's education programme. It is interesting to note that the Government of Bangladesh has already realized its importance and has been showing greater interest towards the development of women in the country.[3]

(m) Emphasis on the Role of State

The last strategy, not necessarily the least in terms of importance, is the well-high emphasis given to the role of state in the Islamic economic development. While Islam recognises individual freedom it does not give any sanctity to the market forces. The state must play the decisive role in guiding and regulating the economy to ensure that the Islamic socio-economic goals are realised. The role of

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[3] For details see Chapter 15.

state should not, however, be confused with 'state intervention' as found in the capitalist economy. In an Islamic economy, 'It is the **obligation** of the Islamic state to play an active role for the fulfilment of the goals of the Islamic system without either unduly sacrificing individual freedom or compromising social welfare' (Chapra 1985, p. 48). He also points out that the strategy should be to bring about a healthy balance between the interests of the individual and the society in accordance with one of the fundamental teachings of the Prophet: 'Let no one harm others or be harmed by others'.

It is the responsibility of an Islamic state to secure the proper environment for the producers, investors and the consumers. This would require, among others, prohibition of all types of illegitimate goods and services, prohibitive monopolies, elimination of *Riba* in all forms, quality control of all goods and services, and adherence to announced specifications. Commitment from the government is also needed to undertake direct investment in areas where individuals is not able or willing to step in.

3. DISTRIBUTIVE JUSTICE IN ISLAM[4]

(a) Conceptual

The issue of distributive justice has been referred to both as one of the goals and has one of the strategies of Islamic economic development in this chapter. A full chapter has been devoted to an analysis of 'Distribution of Income'. That actually referred to 'distribution of income among different productive factors of production in the form of wages, rent and profit'. This distribution is technically called 'Functional Distribution'. In connection with economic development, we have another type of distribution i.e. 'Distribution of Personal Income'. This section shows how income is distributed among different individuals in a society, regardless of how it has been received (rent or profit or any other means). Distinction is also sometimes made between 'Distributive' and 'Redistributive' schemes. When income distribution takes place through mutually agreed transactions among individuals through market, it is referred to

[4] For an excellent discussion on this issue see Zarka 1992a.

simply 'Distribution'. On the other hand, when income distribution is effectuated through special market or non-market forces, it is called 'Redistribution'.

(b) **Goals**

In Islamic economics, distributive justice has specific goals, some are economic and some are ideological. Economic goals are: to guarantee the fulfilment of basic needs (or essentials) of all people living in the society, irrespective of their age, sex, sect or region, and to reduce inequalities of income and wealth. The ideological goals are: to purify the donor's inner-self and his wealth, and to generate good will among the people.

(c) Tools and Schemes

In Islamic economics, there are large number of tools and schemes for achieving the distributive justice in the society. Some schemes are traditional and some are in-built into the Islamic system. Some measures are voluntary and some are mandatory involving institutional arrangements. A few examples are given below.

(i) Replacement of interest by PLS system

The traditional banks operate their transactions on the basis of fixed return system i.e. interest. This system has been found to be largely responsible for the maldistribution of income and wealth in the society. First, it helps widen the income gap between the rich and the poor. Funds collected from millions of poor and rich persons are loaned out to only the rich and relatively rich persons. The poor can provide neither the necessary collateral nor the assurance of repayments as the rich persons can do. Second, it widens the regional gaps. Funds collected from the rural and urban areas are loaned out basically to urban people. Experience in Bangladesh shows that some 60% of the total funds collected through the banking system as a whole are distributed in the capital city (Dhaka) and the rest 40% to the other 63 districts of the country.

The PLS system, on the other hand, involves sharing of profit and loss. The financier needs to examine the economic viability of the project. Whether the client is rich or poor is immaterial to him. If the

projects submitted by the poor appear to be more profitable than those of the rich, he would give priority on the former. Therefore, under the PLS system the poor has a better chance of getting finance compared to the interest-based system. If implemented, this Islamic financial instrument can help redistribute income and wealth in the society.

(ii) Prohibition of unIslamic monopoly

Monopolies may be of two types, natural and artificial. Islamic economics is not necessarily against monopolies. Because peculiarities in the process of certain commodities (such as electricity and gas), certain degree of monopoly will have to tolerated. However, Islamic economics does not support that form of monopoly that always strives to keep the price artificially higher and extracts excessive profits causing hardship to the masses. This type of monopoly is responsible for the concentration of wealth and income in few hands. Islamic economics demands that the government should intervene and control the prices of products (particularly if they are 'essential' in nature) of the monopolists. Thus, prohibition of harmful monopoly can help redistribution of income and wealth in the society.

(iii) Access of natural resources to all

Islam prohibits concentration many natural resources in few hands. One authentic ***Hadith*** is, 'The Muslims are partners of three things, in water, pastures and fires'. Details of the *Hadith* can be seen in the *Fiqh* literature. By analogy (*Qiyas*), many items have been added under the category of natural resources. These include salt, sulphur and naptha. Islamic economics demands that natural wealth should be easily accessible to all people including non-Muslims living in the country and that these should not be too costly for the common people. By implication, access of the common people to basic education is also included in the above list. Perhaps, on the same analogy, Yunus is right when he says, 'Credit is a human right' (provided that this is administered through the Islamically permitted methods). Therefore, by providing more equal access to the natural resources to all, Islamic economics can help improve the distribution of income and wealth.

(iv) Invigorating *Zakat* and *Fitr*

Of the redistributive schemes, which are in-built in Islam, the institutions of *Zakat* and *Fitr* are the most important ones. *Zakat* is a compulsory payment by the rich to the poor. It is generally the responsibility of the state to collect *Zakat* and distribute it according to the Quranic principles. As mentioned in the text, if properly administered, it can contribute 3-4% of the GDP of the Muslim countries.

According to majority of Islamic jurists, *Fitr* is also obligatory on each Muslim, irrespective of age and sex. In other words, each individual pays it for himself and for all his dependants 'as long as he has more than one day's food for himself and his dependants on the night of *Id al Fitr*' (Zarqa 1992a, p.153). Thus, this is paid by even the poor Muslims to those who are poorer, the beggars and the *Miskins*. For a country like Bangladesh, where 25% of the total population are generally regarded as very poor, if the 75% of the country's 130 million people pay Fitr at the rate of (say) Tk. 25, the total amount distributed may come to Tk.25 X 97.5m = Tk. 2,437.5 million. From the view point of redistribution this is not a small amount. A little calculation would show that this amount would, on the average, provide Tk. 1,000 to each individual in a year.

(v) Law of inheritance

Islam has a well-defined law of inheritance. This system leads to the redistribution of the wealth of the deceased. A large number of heirs is recognised. It does not concede a bequest in excess of one-third or bequest for any of the heirs, its impact on the dispersion of wealth is well known.

The system of marriage interacts to a great extent with the system of inheritance in generating distributive effects. Zarqa (1992a, p151) shows that if the coefficient of correlation between the levels of wealth of husband and wife is weak, the impact on the redistribution of wealth increases for the system of inheritance with all the children inheriting. On the other hand, if the rich marry only the rich and the poor marry only the poor (i.e. the correlation is high between the wealth of the spouses), the impact of inheritance on latent redistribution is weakened.

Boulding analysed the effects of inheritance on income and wealth redistribution. He shows that if we assume a society in which life expectancy is, say, 70 years and the wealth is redistributed among different ages, then approximately 1/70th of wealth will be transferred by death and inheritance each. If the output capital ratio is 3, then the wealth transferred by inheritance generates about 3/70th i.e. approximately 4% of the income each year. As the aged are usually more wealthy than the new born, the ratio is likely to reach 8 to 10%. (Boulding 1973, p. 38).[5]

(vi) *Al-Waqf* (Charitable Trust)

The *Waqf* or charitable trust can also be considered as another important distributive scheme in Islamic economics. Throughout Islamic history, the institution of *Waqf* has done tremendous service to the Muslim community. This perhaps owes its origin to the ***Hadith*** i.e. 'A man's works ends upon his death except for three things: (a) contribution to knowledge, (b) on-going charity, and (c) faithful child'. *Waqf* represents one form of 'on-going' charity (*Sadaqa Jariah*). Mannan shows that in Bangladesh, there are over 155 thousand *Waqf* mosque properties as well as non-Muslim trust properties. This can also be created while a person is still alive. Anyone can give some his wealth as *Waqf* and the income generated by this, in the form of services or money, may be distributed to deserving persons. The SIBL has identified as many as 32 purposes for which the benefits of the *Waqf* can be accrued.[6]

REFERENCES FOR FURTHER READING[7]

1. M. Umer Chapra (1985), 2. M. A. Mannan (1984), 3. M. Anas Zarqa (1992a).

[5] As noted by Zarqa 1992a, p.151.
[6] See Mannan 1998, p.p12-13.
[7] For details, see the list of references given at the end of the Book.

Chapter 19

MOBILISATION OF RESOURCES FOR ISLAMIC ECONOMIC DEVELOPMENT

[**Key concepts:** financial resources – deficit financing – voluntary and forced savings – subsistence welfare – equity participation – partnership - ordinary shares – external borrowing – foreign direct investment – small is beautiful – self-employment vs wage employment – formal and informal sectors – micro-credit]

Islam encourages economic development. Its urgency can be realised from the prevailing conditions of poverty, malnutrition, illiteracy and unemployment of the developing Muslim world. Resources are needed for the production of physical assets, which, in turn, are required for the generation of income. Physical assets include machinery, industrial plants and the like.

Traditionally, financial resources are regarded as the basic determinants of economic development and all out efforts are made to mobilise them. In Islamic economics, apart from these financial resources, human resources are given equal, if not more, importance. In this chapter, the following are considered as major sources of finance for Islamic economic development:

(i) Financial resources, and

(ii) Human resources,

These sources are discussed one by one keeping in view the Islamic perspective.

1. FINANCIAL RESOURCES

Financial resources can be grouped into two broad categories namely, **domestic and external.** These two sources are now discussed.

(a) Domestic Sources

There are four sources of domestic finance: voluntary savings, taxation (often called 'forced savings'), deficit-financing and equity participation. Below are discussed all these sources of finance.

(i) Voluntary savings

For economic development voluntary savings plays a very important role. According to Lewis, one of the prominent growth specialists of the conventional economic arena, 'the central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 or 5 per cent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 to 15 per cent of national income or more. This is the central problem because the central fact of economic development is rapid capital accumulation' (Lewis 1954).

Savings is usually defined as:

$$S = Y - C,$$

where,

S = savings
Y = income, and
C = consumption.

Naturally, by definition, if consumption in any society is lower, *ceteris paribus*, voluntary savings would be higher, and vice-versa. It is argued that in the Islamic society, savings would be lower because of two main reasons. First, savings are a function of interest. In Islam this interest is inoperative. Therefore, there will be no or little savings. Secondly, in the Islamic economy, there is a provision for transfer of income from the rich to the poor through such means as *Zakat* and *Sadaqa*. As the former group has higher propensity to consume and the latter has lower, this would imply that there would be less savings in this society.

In the Islamic economics literature, the above arguments have been countered.[1] It is said that the first argument is not based on solid

[1] See Sadeq (1991) and Iqbal (1991).

foundation. John Maynard Keynes in his path breaking book *The General Theory of Employment, Interest and Money* maintains that saving is not necessarily a function of interest; it is a function of income. Moreover, empirical results are in abundance in the literature to demonstrate that people save money not merely for earning interest but for safe custody and for the unforeseen future. The second argument is subject to empirical verification. It is possible to put counter arguments too. When income gets transferred from the rich to the poor, the economic well-being of the poor gets improved which, in turn, will produce positive impact on their health which, again, in turn, will help increase their labour productivity. There would also be an increase in effective demand. All these are expected to promote savings, rather than decrease them. Interestingly Keynes has visualized the situation in a different way. He says that the higher Marginal Propensity to Consume (i.e., lower Marginal Propensity to Save) is essentially an advantage, rather than disadvantage, because it will lead to a higher level of output through multiplier effect.

We can take the discussion a little further to add something on the importance of voluntary savings in Islam. In an Islamic economy, the consumption behaviour of the people is guided by the Islamic norms and values, which demand, among other things, moderation in consumption. As the Quran says, **'And let not thy hand be chained to thy neck nor open it with a complete opening, lest thou sit down rebuked, denuded' [Bani Israil 17:29]**. This injunction for the moderation of consumption implies that the rich persons will not maintain a high propensity to consume rather, by being moderate in their consumption behaviour, they are likely to save more, and not lees as often believed. Again, in Islam, the people are discouraged to hoard their wealth: **'And there are those who bury gold and silver and spend it not in the way of Allah: announce unto them a most grievous penalty,' [Tauba 9:34]**. This gives that Islam encourages the people to make full utilisation of their resources so that more income is generated, not only for themselves but also for the society at large in which they belong to otherwise they are liable to get punishment in the Hereafter.

Moreover, the system of *Zakat* provides an indirect incentive to use the surplus funds for productive purposes. If they do not do so, the 2.5% *Zakat* will ultimately erode their whole savings. In Bangladesh, there exists great scope for increasing domestic savings as would be clear from the information given in Table 1. It can also be seen that the scope for increasing the rate of savings in Bangladesh, compared with the selected Muslim countries, is quite high. Although, the gross domestic savings in Bangladesh increased from 2% in 1980 to 8% in 1995, this rate remains much below the rates of other Muslim countries. Incidentally, the gross domestic savings of Malaysia and Indonesia are 37% and 36%, respectively, in 1995.

Table 1
Gross Domestic Savings of Bangladesh Vis-à-vis Some Muslim Countries (1980 and 1995)

Country	Gross Domestic Savings (as % of GDP)	
	1980	1995
Bangladesh	2	8
Pakistan	7	16
Indonesia	37	36
Algeria	43	29
Malaysia	33	37
UAR	72	27

Source: World Development Report 1997, Table 13.

(ii) Taxation (Forced savings)

It is maintained that most of the Muslim countries are poor and are caught in the vicious circle of poverty, low incomes, low savings, and low investments. Due to this limitation, governments of low-income countries can not avoid the forced savings, that is, taxation. Emphasising the need for such measures, Kaldor says: '...taxes and other compulsory levies provide the most important instrument for increasing .... domestic resources' (Kaldor 1963, p.7).

In Islamic economics. the role of taxation is recognised with caution. Its merit actually depends upon the objective the state wants to achieve with it. If the objective is to meet **subsistence welfare** of the people, imposition of taxes is said to be not only permissible but also necessary; because the amount of *Zakat* and voluntary sources are too insufficient to meet these expenses. If, however, the objective is to improve **living standard of the people beyond the subsistence level,** the imposition of taxes may not be desirable from the Islamic perspective. This is the view of Kahf, an eminent Islamic economist.[2] However, 'majority of Islamic scholars believe that the Islamic state should also attempt to reduce 'relative' poverty by reducing income inequalities and to promote an egalitarian economic and social order' (Iqbal 1991, p. 109). This calls for imposition of taxes.

In a Muslim country like Bangladesh, there exists great scope for increasing tax revenues. This is ascertained by comparing tax as percentage of total GNP in Bangladesh vis-à-vis some selected Muslim countries. The information is provided in Table 2 below. This shows that tax revenue, as percentage of total revenue in Bangladesh in 1995 is only 9.6% compared to 26.3% in Egypt and 20.6% in Malaysia in the same year.

Table 2
Tax Revenue as Percentage of Total Revenue in Bangladesh Vis-à-vis Some Selected Muslim Countries

Country	Tax Revenue as Percentage of GNP	
	1980	1995
Bangladesh	7.7	9.6*
Pakistan	13.3	15.3
Egypt	28.9	26.3
Indonesia	12.5	16.0
Malaysia	23.4	20.6

Source: World Development Report 1977, Table 14.
* inserted

[2] See Kahf 1983.

(iii) Deficit financing

The term 'deficit financing' actually means borrowing money from the central bank. Since this method of financing is intimately related to inflation, it is also called 'inflationary finance'. Resort to deficit financing in undeveloped countries is generally prompted by the inability of the government to raise enough revenue by taxation and other means to meet the necessary development expenditure. In some circumstances it is regarded as an indispensable source of public revenue. According to Keynes, inflation due to deficit financing may promote economic development in two ways. One, it helps redistribution of income from workers (who are assumed to have low propensity to save, and hence, invest) to capitalist entrepreneurs (who have high propensity to save and invest). Two, it causes the nominal rate of return on investment to rise in relation to the rate of interest, and hence promotes investment.

Question has been raised in the Islamic economics literature as to whether borrowing (particularly during the period of inflation) is at all permissible in the eye of Islam. According to Chapra, inflation is unacceptable in the eye of Islam. He explains the reasons in the following words:

> 'Inflation implies that money is unable to serve as just and honest unit of account. It makes money an unquotable standard of deferred payments and an untrusty store of value. It enables some people to be unfair to others, even though unknowingly, by stealthily eroding the purchasing power of monetary assets. It impairs the efficiency of the monetary system and imposes a cost on the society. It raises consumption and reduces savings. It worsens the climate of uncertainty in which economic decisions are taken, discourages capital formation and leads to a misapplication of resources. It tends to pervert values, rewarding speculators (discouraged by Islam) at the expense of productive activity (idealised by Islam) and intensifying inequalities of income (condemned in Islam)' (Chapra 1985, pp. 37-38).

In this regard, the views as expressed by Siddiqi is of quite significance. He says, 'No injunction in the Quran nor in the *Sunnah* prohibits it nor have researchers discovered any rules that might

require such a prohibition. On the contrary, there are examples in the *Shariah* of practical steps to be taken for obtaining loans, and scholars of Islam have clarified the situation by stating that circumstances can arise where the Islamic states will need loans.' (Siddiqi 1983, p.130-31). It is also known from the history of the early Islamic period that loans were contracted by the state though in most cases this was done to meet emergencies (Hasanuz Zaman 1981, pp. 105-106 and 275-76).

It is, therefore, concluded that although borrowing from the central bank may be a permissible source of finance in Islam, large scale financing through this may lead to inflation which is regarded as unIslamic by the Islamic jurists. Therefore, this source should be used only under compelling circumstances.

(iv) Equity participation[3]

Borrowing from the banking system as a source of development finance has its uses, but it inevitably leads to problems if it is used as a means of financing risky ventures or projects that are of long term in nature. From this viewpoint, equity finance can play an important role in financing.

Equity finance means that it is the provider of capital who takes on the risk. This also gives investors a voice in how the business is run, although day-to-day decision making is in the hands of the managers themselves. There are several methods through which equity participation can be materialised.

Partnership: This form of business is appropriate where the businesses are relatively small. If a partnership is created, it will be necessary to have trust from all sides. These are once formed difficult to terminate and there is limited flexibility in bringing new partners.

Private company: This may be formed with several unequal shareholders. This type of company is appropriate for medium sized businesses. There is greater flexibility than the partnership business. If in a country where the stock market is not well developed, this could be used as an appropriate form of development finance.

[3] For an excellent discussion on this source of finance see Wilson 1996.

Co-operative form: This type of business organisation has the merit that it can help widen the business participation and cross fertilisation of ideas in decision making. This can be a vehicle for risk sharing and the spreading of responsibility.

Ordinary shares: This has now become a very popular method of raising capital needed for economic development. In this case the investors need not be guaranteed a return as they do it in the case of bank borrowing. The risk seeking investor knows the return is uncertain, but provides funding in the expectation that his or her judgement will be proved correct, and the risk taken will be rewarded. This can be used as a source of long term finance.

(b) External Sources

There are two purposes for which external sources are used. These are: to supplement domestic resources available for capital formation and to fill the foreign exchange gap. The following three sources are used for procuring financial resources for economic development in an Islamic state.

(i) External borrowing

For developing countries, external borrowing is treated as very important source of financing their development expenditures. Generally loans are available on the basis of interest only, which is strictly prohibited in Islam. The amount of loan that is available from such international Islamic institution as the IDB is utterly negligible. Thus, although the Muslim countries very badly need external loans, they can not but use interest-bearing loans. However, on the basis of the **doctrine of necessity**, Islamic jurists sometimes allow a temporary exception. For example, *the Council of Islamic Ideology in Pakistan* has given the ruling that 'For the time being, external borrowings will have to be continued on the basis on interest'. However, attempts should be made to gradually eschew all interest-based borrowings.

(ii) Foreign aid

Although the net contribution made by the large inflow of foreign aid in the developing countries appears to be controversial, its

necessity can not denied. There are Muslim countries that still heavily depend upon foreign aid for financing their development expenditures. This is not undesirable from the viewpoint of Islam, provided that there are no anti-Islamic constraints attached to it. There are a large number of Muslim countries which have sufficient surplus funds and these can hopefully be utilized for financing the needed expenditure of the poor brothers of the other Muslim countries.

(iii) Foreign direct investment

Foreign direct investment (FDI) is presently being considered as a very promising source of development finance for both developing and least developed countries. There is keen competition among them for attracting FDI. This is advantageous for both the investors and the host countries. For the investors, overseas investments can offer very attractive opportunities in the form of lower wage costs, access to cheap raw materials, possibility to secure foreign markets, exploiting economies of scale, and above all, various attractive incentives by the host countries. On the other end, for the host countries, this source of finance provides a unique combination of long-term finance, transfer of technology, training, managerial expertise and marketing experience and above all the contract in international markets. From Islamic standpoint, this source has special merit: this provides an opportunity to switch the dependence from the interest-based foreign financing to equity-based financing.

It may be of some importance to provide some suggestions, which the host countries should undertake in order to attract the FDI. First, it will be required to develop a clear and precise investment environment which implies spelling out clearly where FDI could step in, and enough information about investment opportunities and legal as well as procedural aspects. Secondly, it will be necessary to ensure full respect for local as well as international agreements and the announced readiness of the host country to protect the parties in these agreements on an equal basis without any discrimination. Thirdly, it will be useful to provide assurance against non-commercial risks, such as continuous strikes, lockouts due to labour unrest, etc. More

importantly, fourthly, legal restructuring of the present laws. where needed, so as to recognise the various formats of contracts that is proposed according to the *Shariah* and determination of the legal position for parties to these contracts. Fifthly, the IDB can play a very dominant role popularizing the joint venture type projects using such *Shariah* permitted instruments as *Mudaraba* and *Musharaka*. It can take the responsibility of collection, verification and analysis of information concerning investment opportunities in Muslim countries, as well as legal and procedural forms in these countries. The IDB quite understandably can demand some fees for providing this information.

In conclusion, it may be added that for meeting the basic needs of the people Allah has given abundant resources, natural and human. As the Quran says, **'It is We who have placed you with authority on earth and provided you therein with means for the fulfilment of your life' [Araf 7:10].** What is required is to make all out efforts to exploit the available natural and human resources for the benefit of mankind

2. HUMAN RESOURCES

The last, but not necessarily the least in order of importance, domestic source of financing economic development of a modern Islamic state is the under- and unutilised human resources. Many Muslim countries including Bangladesh have huge population. In the past, little attention has been given to them (particularly the rural people) on the grounds that they are poor, illiterate, assetless and, and above all, culturally backward. However, some institutions like Grameen Bank in Bangladesh has proved beyond doubt that if the poor can be properly organized and are given sincerely and efficiently supervised financial help they can be turned into assets and can contribute significantly towards economic development in the country. However, the Grameen Bank approach to human resource mobilisation is accomplished on the basis of interest, which is not permissible in Islam. An alternative approach based on permissible mechanism is attempted here.[4]

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[4] The materials used in this section are mainly drawn from Fahim Khan (1992a).

(a) Aims of the Human Resource Mobilisation Programme

The human resources mobilisation (HRM) programme under an Islamic framework has two specific targets namely:

- Mobilising the idle human resources (those unemployed or those reported outside the labour market) to make them economically active; and
- Mobilising those who are already the so-called 'employed' to enable them to improve their living standards.

(b) Strategies of the Programme

(i) Small vs. big

Economic literature still bears the controversy regarding the choice between 'small' and 'big'. However, for a poor agricultural country, the choice appears to be tilted towards the former. For these countries **small** is not only **beautiful** but also **very important.** The emphasis on **small** as against **big** is based on a number of factors. First, about 90 per cent of the people of most of the Muslim countries are small, because as Hamid, with reference to Bangladesh, says, 'Our country is small, the people's capacity is small, and agricultural land is small and, therefore, '**small is really beautiful**' (Hamid 1982). Secondly, the strategy for giving more emphasis on the '**small'** is justified by the fact that the Islamic financial system (as will be noted below) has a built-in mechanism to motivate and support the '**small'.** Thirdly, the amount of investment required for mobilising human resources in these countries is comparatively very small: it is anticipated that this programme may not affect the existing programmes for industrialisation and technological progress. Moreover, 'A proper integration of the small sector with the medium and large scale sectors and adequate assistance to the small sector to adopt new technology will, in fact, accelerate the industrialisation and technological progress' (Fahim Khan 1992a, p. 28).

(ii) Self-employment vs. wage-paid jobs

This is a very crucial choice in connection with the mobilisation of the under- and un-utilised human resources for the

poor but developing Muslim countries. Although many institutions (government or semi-government) appear to prefer wage-paid jobs, the experiences of the NGO-activities in many countries including Bangladesh show that for mobilising human resources the best strategy is to create self-employment rather than provide low-paid jobs. In this connection one remark of Yunus seems to be relevant. He says, 'The world has forgotten the human tradition of self-employment, when people lived in caves they went out to help themselves. There was no state to ask for help'. However, a number of arguments can be offered in support of the self-employment vis-à-vis wage employment (for details, see Fahim Khan, p. 26).

First, a self-employed person is in a position to make decision to expand his enterprise and, hence, his income earning capacity, of course, if opportunities exist. A wage-paid employee lacks this decision-making power.

Secondly, a self-employed person has more motivation and incentive to save as he has an opportunity to use his savings for the expansion of his business and hence improve his economic status. This is not possible in the case of wage-paid jobs, as the person concerned can utilise his savings only by giving them to some one else, an individual or bank, which may give him only marginal returns.

Thirdly, a self-employed person has the opportunity to utilise the maximum time available to him. This opportunity and option is not available for a wage-paid job. In the case of government job, he may not have any control whatsoever over either the availability of time or the wages paid for the overtime. If the job is in the private sector, he may enjoy no such benefit at all.

Fourthly, a self-employed person has control over two of his productive abilities viz., ability to work hard and ability to make decisions. In the case of wage-paid jobs, he can exercise the former but not the latter.

Fifthly, a self-employed or family operated enterprise is the only source of mobilising most of the women of working age in the Muslim countries.

Finally, with his vast practical experience, Yunus opines that 'Wage employment is not a happy road to the reduction of poverty' and that self-employment 'has more potential for improving the asset base of an individual than wage employment has' (Yunus 1987, p.31).

(iii) Formal vs. informal sectors

From the point of view of overall economic development of any country, the contributions of both the formal and informal sectors can not be denied. However, keeping in view the massive poverty of these countries, emphasis is now being given to the informal sectors, both in urban and rural areas. The reasons are as follows.

First, the formal urban sector is in a better position to take care of itself. It is the informal and rural sectors which are more in need of a push.

Secondly, more human resources can be mobilised with a certain amount of investment in the informal and rural sectors in comparison to the urban formal sector.

Thirdly, the promotion of the urban formal sector may help employ those persons who are willing to work. But in the urban informal and rural sectors there are large numbers of people, who are not actually willing to work, truly speaking. Under this comes the women labour force. For bringing them under the self-employment programme, it will be necessary to approach them in non-traditional ways. This is the reason why the Grameen Bank adopts the strategy: 'The people go to the traditional bank, but the Grameen Bank goes to the people'. This is the strategy, which actually can help mobilise some 80 per cent of the population of working age of these two sectors (urban informal and rural) in several developing Muslim countries.

Fourthly, in most developing Muslim countries, people migrate in large number from the rural areas to urban areas in search of jobs every year. The people living in the slum areas are on the increase. Emphasis of the informal urban and rural sectors will certainly help stop this unwanted migration and also help bridge the economic disparity between the rural and urban sectors.

Finally, such an emphasis on the informal sectors will provide competition to the formal sector with respect to the hiring of labour. Remember that the formal sector has to depend upon the informal sectors for the supply of cheap labour. This type of competition when effectuated will help raise the labour wages and hence improve the incomes of the people of informal sectors.

(iv) Supplementary programme

When the self-employed programme is substantially promoted, as an additional strategy, a follow-up supplementary programme is suggested. This would require at least two things. One, attempt should be made to identify those successful self-employing enterprises which have potential for further growth. These enterprises will have to be helped so that they can expand their scope of activities by employing labour from outside. Two, if the chosen enterprises show the potential for further growth, they should be helped to get integrated with the formal sectors.

Interestingly, this strategy is a new one when compared to those followed by the Grameen Bank in Bangladesh. The Grameen Bank considers helping the poor up to the level of poverty. That is, if a member crosses the poverty level, according to the principle of the Bank, he or she is not supposed to be with the Bank.

These strategies have been summarised by Fahim Khan in the following:

> 'Motivate and enable all such human resources that are either not working and contributing anything to family income that are earning (or are living on) an income less than that of market wage of comparable skills, to take self-employing economic activity that can ensure at least an income equal to the formal market wage. As these self-employed human resources gain experience and expertise, motivate and enable them to increase the size of their enterprise to employ more non-family members. As self-employed activities grow into small enterprises, efforts are made to enable them to integrate with the formal sector so that they ultimately are recognised as a part of the formal sector and are no longer a part of the informal sector' (Ibid. pp. 28-29).

(c) Areas of Interventions

Of the strategies described above the motivation and ability of the economically inactive or less active stocks of human resources to take up self-employment jobs is the most crucial one. Implementation of the strategy will depend upon a number of factors including these three:

(i) Ability to produce some goods and services in demand locally;
(ii) Ability to market the goods or services; and
(iii) Access to required capital at the right time, at the right amount and at the right place.

(i) Ability to produce

What would these self-employed persons produce? By definition, the target people we are talking about are basically illiterate and lack the required skill for modern activities. Given the experiences of the Grameen Bank, this is not being regarded as a major constraint. This bank identified some 500 activities, which the poor and illiterate village people can handle without any formal training from outside. These activities include rickshaw or cart wheel-repairing works, wheel making for horse or buffalo or bullocks driven carts, making and repairing fishing nets, sewing, carpentry, running small shops, bidi making, and so on and so forth. These goods and services are being produced by them and by their fathers and forefathers through ages. If any extra skill is required that can easily be acquired at one's own initiative with very little cost, provided there is sufficient motivation to do so. Therefore, it can be presumed that implementation of this stage would require little formal intervention.

(ii) Ability to market

The second area identified is ability of the self-employed persons to market their goods produced. It can be presumed that since in the first stage the persons concerned will produce mainly those goods and services which are in local demand, much intervention may not be needed at this stage too. However, the matter may not be as

negligible as assumed by Fahim Khan when he says, 'The goods, being a part of the bare minimum needs of the local population and, hence, essential are not likely to face a marketing problem' (ibid. p. 30). The experience of Grameen Bank shows that even at this stage, some intervention may be required. One example may be cited here. The people of Chapai Nawabganj district was making *Naksi Kantha* (handiwork on plain cloth with laborious design - one of the very popular hand-works in Bangladesh) with Grameen loan quite on a large scale but they were not getting local market. Ultimately, to keep the production going, the bank had to make arrangements with an exporting company (Arong) at Dhaka that the bank would buy the product from the producers, directly transport them to Dhaka and sell them to Arong for onward sale to foreign countries. The Grameen Bank had to make similar arrangement for its Grameen Check. Therefore, for the development of human resources, necessary intervention may be required: this would of course depend upon the nature the product.

(iii) Access to finance

The financial arrangement is perhaps the most crucial area that needs substantial intervention. The target population we are concerned with lack capital, however small it may be, to initiate self-employment activities. There are two dimensions of this intervention. One relates to generating the supply of the required amount of capital at the right time and place and the other relates to creating demand for available capital.

The supplier of capital will face at least four constraints. One, the target people has nothing to offer as collateral except their body and soul. The supplier must be ready to offer finance without any collateral. Sometimes personal guarantee should be used as collateral. If this is not available, the institution concerned should be willing to provide capital to the potential clients just on the basis of their trustworthy reputation of good character. Two, at the very initial stage it may not be possible to earn any positive income out of the activity. This fact of life should be acceptable to the provider of capital. In

other words, they should be prepared to accept partial or total loss at the initial stage. Three, the amount of capital demanded will be very small compared to the urban formal sector. This implies that the suppliers should be very careful about cost of distribution of funds among too many clients. Four, the last one is of course the fundamental one, that is, the capital will have to be provided without interest but with the methods acceptable in Islam.

The demand for the required capital is likely to be constrained by the lack of motivation of the clients. Because of one reason or other the clients may be afraid of taking money from the formal institutions. He may consider new technology to be very risky. Two major areas of interventions would be:

- Guarantee of minimum needs of the population through some formal system of social security, and
- Capital market.

The capital market is the most crucial area where intervention is required. Interventions in the capital market are required to correct the elements that create bias against self-employing entrepreneurial activities and in favour of fixed wage-paying job opportunities. The corrections would relate to elimination of the need for collateral and linking the return on capital with the performance and outcome of the enterprise into which capital has been put.

3. THE ROLE OF MICRO CREDIT

Micro credit, although an old concept in the world of economics, has been popularised by Muhammad Yunus through his Grameen Bank. The concept has already travelled from a tiny village in Bangladesh to the meeting room of the World Bank. Its latest accomplishment was exhibited through the holding of a Microcredit Summit in Washington D.C. during 2-4 February 1997. The Summit recognised the microcredit as a powerful tool in the struggle to end poverty and economic dependence. The basic objective here is to help the poor to help themselves. Incidentally, there are some NGOs which have also successfully employed microcredit for the creation of self-

employment among the poor. Among these, BRAC and PROSHIKA are pioneers.

However, Grameen Bank (and the NGOs mentioned above) depends entirely upon the traditional mode of financing namely, interest, which is strictly prohibited in Islam. Therefore, in our effort to create self-employment, it would be necessary to find out alternative mode (or modes) of financing. These modes should not only be free from interest but also show its creditability over interest. In the world of Islamic economics, these modes are popularly known as Islamic Modes of Financing. Although these modes have already been explained in Chapter 11, we present below some of the modes that are relevant in the context of human resource development.

(a) Islamic Modes of Financing

Islamic financial modes can be divided into two groups: direct modes and indirect modes. The difference between these two types of modes lies in the degree of risk bearing. In the case of direct modes, the financier bears risk according to the proportion of capital that too for the entire period of the use of the finance. For the indirect modes, the financier bears the risk but does not necessarily correspond to the proportion of investment. Under these modes, the financier can substantially reduce both the intensity of risk and the length of the risk period. The most important modes having relevance to the creation of self-employment among the rural poor are briefly described below.

(i) Direct Modes

Three modes are important: (1) *Qard Hasan,* which means loan without any charge, nor even profit. As said above, a profit-seeking financial institution will not normally like to devote any fund through this mode. However, to make this economically acceptable, the Islamic jurists are now allowing the commercial banks to charge some fee in the name of 'service charge'. This charge should not normally exceed 3 or 4 per cent of the amount loaned out. Although, this charge is announced in advance, the exact rate is adjusted at the end of the period, after the calculation of the total cost involved. (2) *Musharaka:* in this method, the bank and the client share the capital.

The profit or loss is also shared between these two partners according to the share of capital, or according to pre-agreed ratio. (3) *Mudaraba*: in this method the bank provides the entire capital and the client provides the entrepreneurial services. The profit is shared according the pre-agreed ratio. If there is any loss, this is borne by the bank (provided that the loss is not due to gross negligence of the client).

(ii) Indirect Modes

Indirect modes can be divided into three groups, trade-related modes, lease-related modes and service-related modes.

Trade-related modes: The most popular modes are *Bai-Muajjal* and *Bai-Salam*. *Bai-Muajjal* means sales on deferred payments. Under this mode, the bank buys the goods needed by the clients, adds profit on it on mutual consultation and hands over the goods to them. The clients pay back the money either at a time or by instalments. *Bai-Salam* is just opposite to *Bai-Muajjal*. This simply means advance sale. That is, the bank makes the advance payment for the goods to be delivered at some future date.

Lease-related modes: Leasing in itself is an alternative to financing. In this case, the bank purchases items like irrigation equipment and gives it to the clients on rental basis. The lessee retains the equipment as long as he requires and pays the rent. The mode may be called *Ijara*. The leasing is not only a financing mode, it can also act as an alternative to financing. In this case the mode is called **Hire Purchase**. Under this arrangement, the bank becomes the owner of the equipment (say, shallow tube well) and rent it out to the clients on the conditions that they pay the fixed rent per month/season plus a fixed proportion of the total sale price. After the payment of the whole amount, the equipment in question is transferred to the lessee. Therefore, through this mode, the clients can become the owners of the equipment in question.

Service-based mode: In the strict sense of the term, it is not a financing mode, but since through this it is possible to meet the needs of the clients, it can at least be called a 'quasi-financing' mode. In this case the bank offers the clients all the necessary materials to produce

a certain amount of goods and pay for this service on the basis of the completed output. For Grameen Check, the Grameen Bank uses this mode of financing

(b) Basic Features of the Islamic Modes[5]

By definition there will be no place for interest in the Islamic financial system. Here the providers of capital, the financial institutions, share the profit and losses. There will always be some element of risk in the process of financing.

It is possible to take part in financing without risk but that will not bear any profit. The mode through this is materialised is called *Qard Hasan*. A commercial financial institution would not like to indulge in this type of transaction in large scale. However, this is highly encouraged in Islam and the state institutions and the voluntary private sector are supposed to raise funds to meet the *Qard Hasan* needs of members of society.

The Islamic financial system has a provision to collect *Zakat* and other charities from the richer section of the community and distribute them among the poorer section. This is in a sense obligation-free financial support to the poor and the needy. This is called social insurance that is meant to meet the subsistence needs of those whose subsistence is threatened for any reason.[6] Although it is not directly a part of the financial system, it has significant implications for supplementing the role of the Islamic financial system in mobilising human resources. State institutions as well as the private voluntary sector are supposed to organise *Zakat* and charity funds and make arrangements to meet the survival needs of the less privileged members of the society.

The financial institution can borrow from the central banks but that will have to be without interest. As an alternative, the profit-and-loss sharing mechanism is to be followed.

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[5] Sub-sections (c) and (d) are based upon Fahim Khan (1992a).

[6] This provision of the Islamic financial system makes it possible to link the rich persons of the society in to the process of economic development.

(c) Introducing Participatory Modes of Financing

Profitability of the project becomes the primary consideration and the credit-worthiness becomes the secondary consideration, because the return on the project is not fixed but depends on the profitability of the project. In the interest-based system, which guarantees the principal with interest, credit-worthiness is the primary consideration and profitability of the project gets the secondary importance (because its own income is guaranteed by way of fixed interest).

Financial institutions may not be inclined to finance large enterprises as they are in the interest-based system. Neutrality to the size of the enterprise is more likely to prevail. 'Profitability has generally been found, empirically, to be independent of the size of the enterprise' (Fahim Khan, p. 36).

Finances have a chance to be more widely spread and distributed in the Islamic economy. Since the return on financial capital is associated with risk bearing, the diversity of the portfolio is a key to minimising risk. The interest-based system has no compulsion to diversify because with the credit-worthiness feature, diversity will not reduce risk and may be more likely to increase it.

As a logical conclusion, when profitability and diversity are the primary considerations and there is nothing to suggest that these two elements are positively related with the size of the enterprise, smaller enterprises will get more encouragement from financial institutions. Smaller enterprises require smaller financial accommodation and, hence, diversity and spread of risk become less by dealing with smaller enterprises.

There is more likelihood of the efficient utilisation of capital under the Islamic financial system, which forces financial institutions to look for the most profitable and feasible projects. Under the interest-based system, there is no such compulsion as the return on capital is fixed and guaranteed by collateral.

(d) Concluding Remarks

In one of my articles on the Grameen Bank in Bangladesh, I wrote:

> ' ... there exists a unique opportunity for Grameen Bank to develop its own style of **Grameen Islamic Banking.** This, if done, would, among other things, not only create environment for entry into the world of the GB for a larger section of the people who are dead against interest, but also open the door of the bank to the Islamic World and hence attract such world bodies as the OIC and the IDB' (Hamid 1996, p. 77).

REFERENCES FOR FURTHER READING[7]

1. M. Fahim Khan (1992a), 2. M. Umer Chapra (1985), 3. R. Wilson (1996).

[7] For details, see the list of references given at the end of the Book.

Chapter 20

WOMEN IN ISLAMIC ECONOMIC DEVELOPMENT

For your own sake – wake up and use your sight.
Are you sure that you are right? (From a Muslim Woman)

[**Key concepts:** Islamic women – position of women in Islam – sphere of economic activities of women in Islam – participation rate – productive manpower – social needs – 'socio-consciousness-driven' policy makers – dress of women from Islamic perspective – women world]

By nature women constitute half of the total population of the world. For Muslim societies, the same picture holds true. The place of women in socio-economic development is rather beset with many controversies. Even from the viewpoint of Islam, some controversies are not unavoidable. Some believe that women can play an important role in economic development even remaining within the boundaries of Islam. There are others who believe that the women have been assigned with special types of activities and hence they may not participate in all the economic activities as seen in the modern society. This chapter aims to exhibit the actual position of women in economics from the viewpoint of Islamic *Shariah* (we may call them **Islamic women**), identify the types of activities that they may get profitably engaged in and examine the role of women in economic development in Bangladesh from an Islamic perspective.

1. ACTUAL POSITION OF WOMEN IN ISLAM

(a) Quranic Views on Man and Women

One important question: **what is the position of women vis-à-vis men in Islam**? The Quranic answer is as follows:

(a) Men and Women

> **'....Unto men a fortune from that which they have earned, and unto women a fortune from that which they have earned...' [Nisa 4:32]. Or,**
>
> **'Our Lord! Grant us what Thou didst promise unto us through Thine Apostles, and save us from shame on the Day of Judgement: for Thy never breakest Thy promise'. And their Lord hath accepted of them, and answered them: 'Never will I suffer to be lost the work of any of you, be he male or female: you are members of one another'....[Al-Imran 3:194-195].**
>
> **'whoso doeth an ill-deed, he will be repaid the like thereof, while whoso doeth right, whether male or female, and is a believer, (all) such will enter the Garden, while they will be nourished without stint' [Mumin 40:40].**

The message one gets from these verses is very clear. These categorically imply that neither men nor women are supposed to take the responsibility of each other in the Day of Judgement. In other words, their fortunes are simply a function of their own deeds in this material world.

(b) Position of Women During the Prophetic Days

Another important question: Having these injunctions through the Quran, **what was the nature of economic behaviour of the women during the Prophetic days?** Its answer can be sought from the sayings of the Prophet and other doings implicitly or explicitly approved by him as noted below:

> Narrated by Ayesha: She said, ' Jainab was the most generous amongst us. Because she used to work herself and give charity' **(Muslim).**
>
> Narrated by Zubair: 'Once the Prophet came and found her wife, Jainab, tanning skin' **(Muslim).**
>
> 'Surely Allah has permitted you (women) to go out in order to meet your needs.' **(Bukhari** and **Muslim).**

Apart from these *Hadiths*, a few practical examples can be cited from the Islamic history:

> Among the first Muslim generations were many women who worked. The trading activities of Khadija (the Prophet's first wife) are well known. Although she did not actually go out with the caravans of goods, she was a woman who was in full control of her own wealth and business. During the Prophetic period, the women used to help their husbands in agriculture. Hazrat Asma bint-e-Abubaker, wife of Hazrat Zubair, used to work in the field of her husband, two miles away from home. Ibn Saad in his *Tabqat* has reported that one woman *Sahabi,* Asma bint-e-Muharrama, used to trade in 'Atar' (a kind of scent). Ibn Saad has also reported that another woman *Sahabi,* Umar bint-e-Tabiza, used to go to market and purchase necessaries of her husband. Ibn Abdul Bakr in his book *Al-Istiab* has stated about a woman *Sahabi,* Hazrat Shifa, that Hazrat Umar entrusted her with some responsibilities of market management....Of course the Muslim women used to put on long sheets of cloth (*chadar*) over their normal dress as prescribed in the Quran. There are also numerous reports in the books of *Hadith* and in the books of history that Muslim women participated in the early wars of Islam along with the Prophet as nurses and helpers. At times, they participated in actual combat when necessities arose.[1]

The message one gets from the above passage is clear and unambiguous. Islam recognises the vital role of women in the family and in the society. During the Prophetic days Muslim women used to participate in the economic activities and that, when necessary, they used to go out of home (with the dress approved by Islam).

2. ECONOMIC RIGHTS OF AN ISLAMIC WOMAN[2]

The economic rights of an Islamic woman can be summarised as follows:

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[1] These are taken from Hannan 1980, pp. 238-239 and Khattab 1993.

[2] This section is based on Doi (1996), p. 154.

(i) An Islamic woman is entitled to inherit from her father, her husband and her children too.

(ii) She is entitled to *Mahr* from her husband, which is a gift given at the time of marriage. It is obligatory on the part of the husband to give dowry: **'And give women their dowries as a free gift' [Nisa 4:4]**. Its amount is a function of the financial status of the husband and the woman concerned. All money or other property she gets from these or from other lawful sources solely belongs to her and her husband can claim no legitimate share in them according to Islamic *Shariah.*[3]

(iii) She can, when needed, run her own lawful business and, if she wishes, keep the whole income to herself. Strictly speaking, Islamic law does not put any responsibility for domestic expenses on her.

(iv) Allah orders husbands: 'To retain their wives in kindness and to release them in kindness' in case of divorce. This implies that the dowry and the right to receive maintenance during a period under divorce are fully granted to the wife by the Quranic injunctions.

(v) If the husband dies, the wife's rights as mentioned in the marriage contracts have a priority in settlement of his property.

These economic rights have been granted by the *Shariah* to give an Islamic woman economic security within marriage and after its dissolution either by husband or by the death of the husband.

As a concluding remark about the economic rights of an Islamic woman, it is interesting to mention the opinion of Khurshid Ahmad. He says that the stress of women with respect to inheritance, property, marriage, and divorce is much higher in Islam than in other religions. He also urges that the world must know and accept the truth that no other faiths have given womenfolk so many rights and preserved their chastity as Islam has done.

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[3] Feminine writers can write for the establishment of these types of economic rights for the Islamic women rather than attacking the Quran, the Holy Book of the 1250 million living Muslims in the present day world.

3. SPHERE OF ECONOMIC ACTIVITIES OF ISLAMIC WOMEN IN THE MODERN SOCIETY

We begin with a misconception about the contributions of women folk in the modern economic development. Women of developing countries like Bangladesh, Pakistan and India are regarded as unemployed and hence are generally termed as loss of productive manpower. It is generally believed that development suffers and the country remains backward unless the women come out of their home and start working along with their male counterparts. Based on this type of conviction efforts are now being made in many developing countries including the Muslim ones to encourage women to participate in economic activities not only along with men but also to travel widely and freely in the field by using whatever means available (particularly, by-cycle and motor cycle) like their male counterparts without recognising their social consequences.

On the one hand, it is rather unfortunate that the women are generally regarded as unemployed and unproductive. Consider the case of Bangladesh, which is basically an agricultural country. Here the village women remain busy not only for rearing their children and managing their home, but also they engage themselves in such productive activities as paddy husking, cow and goat rearing, vegetable gardening, embroidery works, handicrafts, tailoring, weaving, paper bag making, and so on and so forth, without necessarily going out of their home. It is believed that the women remain engaged in various activities for more than 15 hours a day: in contrast the official time is 8 hours. Even in the cities, the women generally work for more hours than their male counterparts. Research studies show that the educated women of the cities spend quite a few hours, apart from other household activities, in teaching their sons and daughters. Should they still be called 'unemployed' and term them as 'unproductive'?

Fortunately, the definition of 'economic activities' performed by women are being changed, and gradually, their economic contributions to socio-economic development are being recognised.

This realisation is seen to be reflected in the World Bank's estimates of per capita income of different countries of the world. One tangible result of this change is the increase of per capita income of many developing countries (where women remain engaged mostly in the household activities) and decrease of the same in the developed countries (where women engaged in the so-called productive activities). For example, according to purchasing power parity (PPP) estimates of GNP, per capita income of Bangladesh, Pakistan and India increased from, respectively, US$ 240 to1,380, from 460 to 2,230 and from 340 to 1,400; and those of Switzerland, Japan and Norway decreased from, respectively, US$ 40,630 to 25,860, from 39,640 to 22,110 and from 31,250 to 21,940.[4] In Bangladesh too, the definition of 'economic activities' has gone under change. This is reflected in the rate of women participation in economic activities.[5]

Against this background, in the Islamic economics literature attempts are being made to identify the sphere of economic activities of the Muslim women in the modern society. For example, Hannan has suggested the following activities of Muslim women for which they can come out of their home. (Ibid. pp. 239-240).

(i) **To manage own business and property:** According to the principles of Islam, women have the right to inherit property from parents, husbands, and other relations. Naturally, as the owner of the property, she would be required to go out to manage her property when necessary.

(ii) **To meet social needs:** They can work in such social institutions as Schools, Colleges, Universities, Hospitals, Maternity Centres, Dispensaries, Clinics, Industrial homes, and Orphanages meant for girls and women.

(iii) **To earn their livelihood:** In cases where there is no male members to support, the women are permitted to work outside.

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[4]All figures are in US dollars and refer to 1995. In this calculation the per capita income of the USA is taken as the base data. See The World Development Report 1997, pp. 214-215.

[5] See Section 3(b) below for illustration.

Under this category would come widow, unmarried girls, family with only daughters, family with children among whom the daughters are elder than sons, family with parents who are too weak or too old to work, and family with insufficient income to meet the needs of the family.

It should be added that while performing the above-mentioned permitted activities, the concerned women should be dressed as per instruction of the Quran (and also the *Sunnah).* Regarding the dress, the Quran says, **'O Prophet! Tell thy wives and daughters, and the believing women, that they should cast their outer garments over their persons (when abroad): that is the most convenient, that they should be known' [Ahzab 33:59].** Again in *Sura* **Nur, Verse 60,** it is instructed, **'As for women past child-bearing, who have no hope of marriage, it is no sin for them if they discard their (outer) clothing in such a way as not to show adorment (beauty). But to refrain is better for them, Allah is Hearer and Knower.'**

Negatively, an Islamic woman will remain aloof from unlawful activities. It should be remembered that the roles of the spouses are biologically determined. Because of their different physiological structures and biological functions, each sex is assigned a role-play in the family. Islam affirms this differentiation in black and white. Consequently, she will not work as a dancer, a model, a barmaid, a waitress, a film actress or a prostitute to sell her femininity in order to make money even with the consent of her husband.

An Islamic woman will not accept secretarial work particularly in an environment surrounded by men or in an atmosphere where she is required to sit solitarily and continually alone with her boss. In this type of environment, it often happens that the secretary becomes a keeper of her bosse's secretes and ultimately becomes his mistress. According to a *Hadith.* when a man and a woman sit alone anywhere, *Satan*, whose work is to guile mankind, makes a third person. While describing the experiences of working women side by side their male counterparts in the offices, factories and industries of the Western societies Hannan says: 'As a result of free mixing in the West, family ties have weakened, divorces have increased, children

have suffered from lack of parental care and even rapes have increased.' (Hannan 1980, p. 240).

4. ROLE OF WOMEN IN ECONOMIC DEVELOPMENT IN BANGLADESH

This section is devoted to an evaluation of the role of women in economic development in Bangladesh from an Islamic perspective. To begin with let us see the nature and extent of the women participation in various economic activities.

(a) Nature and Extent of Women Employment[6]

(1) According to the Labour Force Survey (LFS) 1990-91, the women participation rate is 58.2% as against 8.2% in 1984-85 LFS. This jump is, however, due mainly to the wider definition of economic activities of women as noted above. For obvious reason, this rate is higher in the rural areas (65%) than that of the urban areas (30.1%). The rate of participation for the male is 79.6% for the same year.

(2) When considered in terms of occupational structure, the 1990-91 LFS gives that about 65% of the women working in the urban sector are in agriculture, forestry and fisheries sectors. The percentage of working women engaged in the service sector is 17. In other sectors, particularly in the administration and managerial works, the figures are very negligible. In the rural sector too, the agriculture, forestry and fisheries dominate the scene. This percentage is as high as 90, followed by production and transport sector (4.4%) and others.

(3) The LFS also provides women participation in economic activities according to major industry groups. It is seen that while agriculture occupies 64% of the women workers in the urban areas and 87% in the rural areas, employment in the manufacturing sector is insignificant, 8.8% in the urban and 8.5% in the rural areas, respectively. In the agricultural sector, most women are seen to be

[6] This section is prepared around the materials provided in Nasreen Khundker 1997.

unpaid family workers, 98.2% of the employed women population in the urban and 94.6% in the rural areas, respectively. The non-agricultural sector, on the other hand, is dominated by the self-employed (14% in the urban areas and 48.8% in the rural areas), and employees (77% in the urban and 25.5% in the rural areas).

It is important to point out that the proportion of the self-employed in the non-agricultural sector jumped from 15.9% in 1983-84 to 63% in 1990-91. This is said to have been 'made possible by an increased flow of credit and other organisational support by the Grameen Bank and other NGO programmes replicating the Grameen model' (Khundker 1997, p. 417). For example, the Grameen bank alone disbursed Tk 96,516 million up to May 1998 as credit to its 124,620 members, 95% of whom were women. Most of these loans have been utilised by women in small-scale activities, the most important ones being livestock and fisheries, followed by agriculture and forestry, processing and manufacturing, and trading.

(4) From the Census of Manufacturing Industries (CMI) a more detailed information on the nature and extent of women employment in Bangladesh is available. It is seen that in terms of numbers employed, the predominant women activities are food manufacturing, particularly rice milling, tobacco manufacturing, textile including handloom textiles, and readymade garments industries. According to the BGMEA, the number of women employed in the readymade garments industries exceeded one million in 1995-96. According to CMI during the period between 1985-86 and 1991-92, the incremental share of women workers engaged in manufacturing industry is 6 times that of male workers. Khundker points out that 'while there has been an increase in the percentage of production-related and hired workers, there has been an actual decline in the proportion of women who are employed as administrative/clerical/sales workers, or in the category of directors/ partners/ proprietors...' (Khundkaer 1997, pp. 417-18).

(5) Another aspect of women employment is that the women employment as a proportion of total employment is continuously on the increase. Whilst it was only 3.04% in 1985-86, the proportion increased to 15.9% in 1990-91. This proportion varies quite markedly

among industries. The proportion is the highest for embroidery of textile goods (97%), followed readymade garments (69%) and bamboo and cane products (66%). This proportion is naturally quite low for such industries as bricks, tiles and clay products (1.45%) and cotton textiles (0.92%). In the country's two EPZ (Chittagong and Dhaka), the ratio of women employment is two and half times the ratio of male employed.

(6) Apart from the nature and extent of women employment in the various economic activities, it is also of importance to say a few words about wage bill. As one would expect, the share of women wages is much lower compared to the share of women in total employment. For example, while the share of women employment was 69% in the readymade garments industry in 1991-92, the share of wages was 61.4%. The aggregate share of wages for all industries covered by the CMI was only 8.5% in 1991-92, compared to an employment share of 15%. The detailed information as given by the CMI shows that the majority of women, specially in rural areas, are seen to earn below 150 taka per week in 1990-91. Eighty four per cent of rural women participants and 57% of urban women employed are found to be in this low-income wage category. The corresponding figures for men are 69% in the rural areas and 31% in the urban areas. Nasreen Khundker in her study shows that for readymade garments and wearing apparel the wage gap is 22-30%. What is more alarming is that the wage-gap is increasing over time.

(7) Another feature of women employment in Bangladesh is the higher employment rates for younger women. The LFS 1990-91 gives that for the country as a whole, the employment rates are the highest in the age group 15-34 years. This is also suggested by a study of the readymade garments industries by Majumder and Chowdhuri (see Khundker 1997, p. 418).

(b) Some Observations and Suggestions

(i) Some observations

Against the above background, we now pass on to make some observations and at the same time make policy suggestions from an Islamic perspective.

Firstly, it has been found that the number of self-employed women is fast increasing in Bangladesh, particularly in the rural areas. Among the institutions making this happen, the NGOs including the Grameen Bank are the most dominant ones. Undoubtedly, these institutions are playing effective role in increasing the utilisation rates of women labour force, thereby contributing towards reducing the women unemployment in the rural Bangladesh. However, from an Islamic perspective this type of institution faces a number of criticisms. The most obvious one is that these institutions like other conventional financial ones operate their activities on the basis of **interest**, which is condemned in Islam. **'But Allah hath permitted trade and forbidden usury' [Baqara 2:275].** On the other hand, the rate of interest (although not relevant) is **extremely** high. For instance, Grameen Bank, a bank meant for the poor, and only for the poor, charges 20(interest) + 5(compulsory cut in the name of group fund) = 25% interest. If the case of weekly instalment is considered, the effective rate becomes 33.5%. One may consider this as a good example of *RIBA* as mentioned in the Quran. The Grameen Bank can not deny this criticism but justifies it by saying that **it is doing business** and that interest rates lower than this will not make the bank viable at all. It also claims that its services to the clients do compensate the high charges made to them.

As discussed in the previous chapter, Islamic economics provides many alternatives which are more fruitful and more effective when compared with the age-old traditional method, i.e. interest. An attempt should now be made to replace interest by the Islamic modes of financing.

Secondly, another significant finding of the above analysis is that the number of women employees has been increasing quite noticeably in Bangladesh. This has happened due mainly to expansion of readymade garments industries in the city areas. This message is both a matter of happiness and a matter of concern. This is good news because, it is giving an opportunity for the poor and destitute women to earn their livelihood. They are also contributing towards industrial development of the country. There is, however, another side of the picture which concerns not only the Islamic economists but also the

'social-consciousness-driven' – to borrow a phrase of Yunus of Grameen Bank – policy makers. Let us note down some important socio-economic characteristics of the women employed in the garments industries:

> '... employment of women far outnumber that of men, 30% of workers had completed 5 to 10 years of schooling, and another 20% had an education of secondary level and above. **Most of the women workers are also found to be unmarried and all below the age of 30.** ... a sizeable proportion are recent migrants from the rural areas.... Shared living arrangements (messing) is common for these girls, but condition of the housing is poor. Frequent changes in shelters is also the norm, since landlords are reluctant to accept girls as tenants. .... Few (factory premises) are purpose-built and therefore unable to provide adequate facilities, and some cases of death due to fire have also been reported in the press. ... Security is another issue of concern for all categories of workers, but particularly young girls ....in industrial employment who need to mobile in getting to and from work, or visit families living in the rural areas. The violation of such basic rights have been particularly highlighted in the Yasmeen murder case, but many other cases remain unreported' (Nasreen Khundker 1997, pp. 420-21).[7]

Disregarding the pure Islamic concern, can the 'socially-consciousness-driven' policy makers remain indifferent to the social implications of the above characteristics of the women working in the garments industries? Definitely not. There are people who might tend to suggest that the young women should not be allowed to work in the factories under the prevailing circumstances. To my mind, if this suggestion, although very forceful, is activated this would create more problems than it would be expected to solve. What is perhaps more appropriate is to create a 'women-world' in which they can do their economic activities without any shame and fear. Some suggestions in relation to housing, security, the legal and institutional framework governing working conditions are given in this regard.

[7] The information contained in the paragraph are actually drawn from various research-based publications. The readers interested in the original may consult her article mentioned in the text.

• Housing is an important issue for the young unmarried workers in the readymade garments industries. This is particularly required for those who have no families living in the urban areas. The Government along with the 'socially-consciousness-driven' NGOs should come forward to build low-cost housing for women workers. It should be mentioned that the Women's hostel built in Dhaka is not meant for the women we are talking about. Factory premises will have to be improved. Working environment should be free from health hazards and asocial elements of the factory workers.

• Security will have to be ensured to each and every worker within the factory and outside. Legal and institutional framework governing the working of the women workers will have to be reformed. While a number of labour laws exist to protect the interest of women workers such as the Factories Act 1965, the Maternity Benefits Act 1939, and the Children (Pledging of labour) Act 1993, these suffer from many inadequacies and proper monitoring. Some protective legislation such as prohibiting night work for women should be reviewed in relation to both the needs of the factory and working environments.

• While designing appropriate institutional design for women, it should be remembered that the physical and mental conditions of women are quite different from those of men.

Thirdly, another finding, which is of much importance to all of us, is the wage-gap between men and women. The Quran categorically says, as mentioned above, **'.... Unto men a fortune from that which they have earned, and unto women a fortune from that which they have earned...' [Nisa 4:32]**. In other words, while giving remuneration, men and women must be treated equally. If they perform similar type of functions, their remuneration must be the same. It is the responsibility of the government to see that the women are not deprived of their right share.

Fourthly, the analysis of the nature and extent of women employment in Bangladesh reveals that although the definition of economic activities of women has been widened, the rate of participation of women still remains low (58%) compared to male

(80%). For many families, because of lack of male earning members and also because of very poor earning of the male members, the socio-economic circumstances are extremely poor. To ignore these types of necessities of the society is not only against humanity but also very much against the spirit of Islam. It is, therefore, suggested that their participation rate should be increased along with men.

Fifthly, service rules may have to be amended for the benefit of women. One very important case relates to widowed women. The service rule may be amended so as to allow widowed women to enter into the government job without any age limit, keeping, of course, the necessary qualification requirements (such as education) unchanged.

Finally, the working women should be encouraged to wear dress as per instructions of the Quran (and the *Sunnah)*, as mentioned above.

(ii) Some Suggestions

Some suggestions for raising the participation rate of women are given as under.[8]

Nurseries and Childminding

- Nursery is traditionally a female preserve. There is a crying need for Muslim playgroups/nurseries and appropriately trained staff, particularly in the non-Muslim countries.
- Childminding is an ideal home-based job. Those Muslim women who have to go out to work can look out for childminders. For women who enjoy caring children, this provides an opportunity to help their fellow sisters who are working outside home.

Teaching at Various Levels

- In the primary schools, all teaching posts can be reserved for women. If this is not immediately possible, at least, the women can be given preference over men.
- All the posts in the girls schools, colleges, and women universities (if any) can be reserved for women. Perhaps, given the recent experiences of not only Bangladesh but also in many other

[8] These suggestions are mainly taken from Hannan 1980, p. 240 and Khattab 1993.

countries of the world including the Muslim ones, no body would dare to make any doubt on their capabilities in managing these institutions themselves.

Hospitals

- All the children hospitals and maternity centres can be handed over to women.
- Half of the general hospitals can be converted to 'Women's Wing' and given to the women for over all management.

Cottage Industries and Social Activities

- Islamic women can very well be engaged in various cottage industries. Apart from the traditional activities like sewing and bamboo works, the Islamic women can do a lot in dressmaking and designing. There is definitely a need for affordable *Hijab* – in all sizes and styles. Women who can design and/or sew could provide a service to their fellow sisters, as well as making money from home. In developed countries like the USA, it has been found that Islamic women form co-operative to make clothes and sell them by post; this helps the more isolated sisters who are not within easy reach of the shops that do cater for women who wish to dress Islamically.
- Many non-Muslims somehow have got the idea that Islam is 'too dry'. This is not true when one listens to the old songs, and looks at the bazaars and mosques in the Muslim cities. Therefore, Islamic women artists are very much needed to enrich the Muslim culture within the bounds of the *Shariah.*
- Separate Social Welfare Department and Cottage Industries Corporation can be established and can be handed over to the women for management. These institutions can be developed for the rehabilitation of the rootless and distressed women and for similar social works.
- Islamic women can be most effective in the juvenile courts and welfare institutions of our society. With their Allah-given touch of loving affection they can handle juvenile delinquents, drop-outs from schools, or frustrated youths.

- Older women can be employed in the industries that involve lighter works.

Computer Link and Media

- Secretarial and typing skills can very well be offered from home especially with the advent of computer links, internets and other wonders of modern technology; people will always need documents, reports and theses typed up – this kind of work is also suited to working at home.
- Media and publicity is another area where Islamic women can engage themselves profitably. They can work as free lance writers or can take the responsibilities of editorship of magazines and journals. There is tremendous scope for writing for the establishment of economic rights of Islamic women as described above.

Law and Order

There can be small women police force specifically to deal with the women criminals. The force should not, however, be used for traffic or for patrolling duties.

It should be remembered that all works are considered as *Ibadah* in Islam, if these are performed with pure motive and seek the pleasure of Allah. Whether an Islamic woman works as housewife mopping kitchen floor or changing nappies or a high-flying manager of a successful company, her work will have contribution towards economic development of the society she lives in.

REFERENCES FOR FURTHER READING[9]

1.Nasreen Khundker (1997), 2. Shah A. Hannan (1980), 3. A. Rahman I. Doi (1996).

[9] For details, see the list of references given at the end of the Book.

Chapter 21

THE ISLAMIC WORLDVIEW AND THE ISLAMIC RESPONSES TO THE THIRD WORLD SOCIO-ECONOMIC PROBLEMS

[**Key concepts**: The Islamic worldview – *Tawhid* – *Khalifa* – *Adl* – integration of material and moral dimensions – moral dimension in motivation – moral filters – intermediate goods and services – vicious circle - investment climate – economic holding – small and micro enterprises – Loan Guarantee Scheme]

Given the failure of the Socialistic and Capitalistic systems to offer solutions for the prevailing socio-economic problems of the Third World countries including the Muslim ones, it is necessary that the Muslim countries adopt a new system, the system based on the Quran and the *Sunnah* for finding the solutions for their own problems. This chapter is devoted to discussing the Islamic solutions to socio-economic problems with particular reference to the developing countries. The materials of this chapter are mainly drawn from the famous book *Islam and the Economic Challenge* of M. Umer Chapra.[1]

Before we come to the points, it would be worthwhile to have some ideas about the Islamic worldview.

1. THE ISLAMIC WORLDVIEW

In Islam, human beings are treated as living and indispensable element of the economic system. They are the ends as well as the means. Consequently, it is required that they are reformed and

[1] Although most of the materials used in this Chapter are drawn from the book referred to here, the consequences of the additions, subtractions, interpretations made are borne by the author himself.

motivated to pursue their self-interest within the constraints of social well being. The worldviews of capitalism and socialism do not treat human beings in this fashion. In these systems, there is an overly exaggerated emphasis on 'survival of the fittest' or 'class struggle' and 'maximum want satisfaction' or 'material conditions of life'. They do not have any mechanism to induce human beings to work in the interest of the society. Islam has a worldview and a strategy, which are in harmony with welfare of the human beings that satisfy both the material life and the life Hereafter. This is elaborated below.

The Islamic worldview is based on three fundamental principles, which are:

- Divine Unity (*Tawhid),*
- Vicegerency (*Khalifa)*, and
- Justice (*Ȧdl).*

These principles are blended together into a whole and there is complete harmony between them. The meaning and significance of these principles are briefly stated below.

(a) Divine Unity *(Tawhid)*

The foundation stone of the Islamic faith is Oneness and Unity of God (i.e. Allah), the *Tawhid.* The worldview of Islam rests on this concept. In a sense, everything else logically emanates from it. This also means that the whole universe has been consciously designed and created by Allah, Who is One and Unique and has not come into existence by chance or accidence. **'... Our Lord! Thou createdst not this in vain' [Imran 3:191].** In other words, everything created by Him has a purpose. Again, **'Lo your Lord is Allah Who created the heavens and the earth in six days, then He established Himself upon the Throne, directing all things...' [Yunus 10:3].** That is, Allah is actively involved in all affairs and is deeply concerned with even the minute details.[2]

[2] (see *Sura* **Luqman,** *Ayat* 16, for instance).

(b) Vicegerency *(Khalifa)*

According to the Quran, the human being is treated as vicegerent *(Khalifa)* of Allah. He is endowed with all the mental and spiritual characteristics, as well as material resources, which are enough to enable him to live up to his mission. Within the terms of reference, he is free, and is able to think and reason, to choose between right and wrong, fair and unfair, and to change the conditions of his own life, his family and the society he belongs to. This concept of vicegerency has a number of implications as stated below.

First, vicegerency implies the universal brotherhood of mankind. Everybody, irrespective of his sex, race, colour and region, is a *Khalifa.* Within this framework, the right attitude towards other human beings is not 'might is right' or 'survival of the fittest' but mutual help, co-operation and sacrifice required to fulfil the basic needs of all, to develop the entire human potential, and to enrich human life.

Second, human being as a vicegerent of Allah **[Baqara 2:30]** has been subjected to use everything in the skies and earth **[Luqman 31:20]**. All these imply that human being has no absolute ownership on anything, the absolute ownership belongs to Allah. This further implies that he is nothing but just a trustee of the resources provided by Him. This trusteeship *(Amanah)* does not negate the private ownership but carry a number of implications. That is: (i) the resources are to be used for the benefit of all including animals; (ii) these are to be used in the manner as dictated by the Quran and the *Sunnah;* (iii) full and effective utilisation of all resources are to be ensured; and (iv) no human being is authorised to destroy or misuse any Allah-given resources, including himself/herself.

Third, vicegerency also requires that men follow the life-style as dictated in the Quran. **'So let thy purpose (O Muhammad) for religion as a man by nature upright – the nature (framed) of Allah, in which He hath created man' [Rum 30:30].** Therefore, the only life-style that suits vicegerency is one that is good and noble. Otherwise, this would lead to extravagance and waste resulting in unnecessary pressure on the available resources.

Fourth, still another implication of vicegerency of Allah is that man is free to do anything and his freedom is subservient to none but Him. In other words, his freedom is subject to restriction of the social responsibility as specified by the *Shariah.*

(c) Justice ***(Adl)***

Establishment of justice and eradication of all forms of *Julms* or injustice has been stressed by the Quran as the prime duty of all Allah's Messengers. As the Quran says, **'We sent aforetime our apostles with clear Signs and sent down with them the Book and the Balance (of Right and wrong) that men may stand forth in justice....' [Al-Hadid 57:25].** From the viewpoint of human welfare, this principle implies the following.

First, for the establishment of socio-economic justice, the first thing that will have to be done is that all the Allah-given resources must be utilised to satisfy the **basic needs** of all persons in the society. As one *Hadith* says, 'He is not a man of faith who eats his fill when his neighbour is hungry' **(Bukhari).** Given the limited resources, this Islamic goal can not be materialised unless claims on the available resources are made only 'within the limits of humanity' (Sulayman 1976, p.20) and well-beings of the general masses. The Islamic jurists are in the complete agreement that it is the collective duty *(Fard Kifayah)* of Muslim society to take care of the basic needs of the poor.

Secondly, according to the principle of Islamic economics, a person must strive to earn his livelihood through his own efforts. It is the collective responsibility of the Muslim society to ensure an equal opportunity for everyone to earn an honest living in accordance with his/her capability. Those who, in spite of their best efforts, are not in a position to make a minimum living standard, it will be the obligation on the part of the society to help them through other means such as transfer payments through, say, *Zakat, Sadaqa* and other forms of voluntary and compulsory contributions.

Thirdly, justice demands that income and wealth do not concentrate in few hands. This also owes its origin to the Quran i.e., **'Wealth does not circulate only among your riches' [Hashr 59:7].**

It is the general view of the Islamic scholars that if the social behaviour pattern and the economy are restructured in accordance with the principles of Islamic *Shariah*, there can not be any extreme inequalities of income and wealth in an Islamic society.

Finally, the concepts of vicegerency and justice demand that the Islamic society must strive to achieve reasonably high rate of growth and maintain high degree of stability within the economy. Truly speaking, without growth and stability, improvement of the human welfare up to a desired extent will not be possible.

2. ISLAMIC RESPONSES[3]

Most countries of the world, including the Muslim ones are presently in a state of turmoil. Poverty and inequalities have become more marked. The gap between the rich and poor is anything but widening. There are microeconomic imbalances reflected in high rates of inflation and unemployment, excessive budgetary and balance of payments deficits, and volatility in the foreign exchange earnings. The developing countries are plagued by difficult debt-servicing problems. The people are suffering from high level of stress and tension, frustration, crime, alcoholism, drug addiction, divorce, child harassment, mental illness and suicide. Of late, practically all countries of the world are experiencing a scale of depletion of non-renewable natural resources and environmental pollution, which is endangering life on earth. The Quran says:

> **'And if they strive in Our Cause, We will certainly guide them to Our Ways, for Allah is undoubtedly with those who strive for the good' [Ankabut 29:69].**

Taking inspiration from this Divine guidance and against the Islamic worldview as described above, we shall now make an attempt to discuss the possible solutions from an Islamic perspective to meet the socio-economic problems facing the Third World Muslim

[3] As a supplementary source, particularly for Bangladesh, the readers – are advised to read Essays (Nos 13, 14 and 15) of Shah Muhammad Habibur Rahman (1996).

countries including Bangladesh. At the very outset, it should be borne in mind that the policy measures suggested below might not necessarily be new particularly to those who are well versed in development literature. What is claimed new in Islamic economics is its emphasis put on certain factors normally neglected by the traditional economics. Of particular importance is the emphasis on the **integration of material and moral dimensions of life.** Therefore, in the context of human welfare, both the material and spiritual aspects are considered. The solutions are discussed under the following four heads:

- Activating the human factor,
- Economic reforms,
- Distributive reforms, and
- Financial reforms.

(a) Activating the Human Factor

Since human well being is considered to be the overall objective of Islamic economic development, it is the human beings who should come forward and take the lead to do all that is necessary. This is, however, highly unlikely to take place automatically. There must be some 'pull' and 'push' factors that should help activate the human factor. These are explained below.

(i) Motivation

The first factor for activating the human being is motivation. It is believed that unless and until the individuals are properly motivated, no system can realise either efficiency in resource allocation or equity in distribution. The psychological force, which acts behind motivation, is 'self-interest'. Under socialism, this personal interest is denied. Under capitalism, although self-interest is allowed, its assumption of automatic harmony between self-interest and social interest is not valid. Whenever, there is a conflict between these two interests, social interest gets jeopardised. This is not unnatural. In Islamic economics, a new factor is injected into the system to take care of this socially unaccepted human tendency. This is the **moral dimension**. This moral

dimension will not work automatically unless there is a **mechanism built-in** it. This is accomplished through the necessary restructuring of the socio-economic system. Some of these elements - socio-economic justice, social environment and moral consciousness- of this restructuring are discussed below.

Firstly, it should be realised that people hardly get due reward for their hard work, creativity and contribution to output. Hence, it is required that the people and the policy makers, should be motivated to establish socio-economic justice in the society.

Secondly, it would call for motivation to create social environment. Most of the Muslim countries are poor. Majority of them live in the rural areas. The socio-economic policies adopted by these countries are biased against the agriculture and small-scale enterprises. Motivation is required to remove the bias of these official policies. The relationship between the employee and employers is not congenial. They are not paid the real wages they deserve. They do not enjoy any job security. They are to work, sometimes, from dawn to dask. Islamic values require that the employee and employers belong to the same 'family'. This demands that this Islamic spirit is injected into the employee-employer relationship.

Thirdly, in Islamic economics, motivation has a moral dimension. Islam has a great potential for creating the desired qualities in people and for making them identify the social interest with personal interest. Chapra opines that 'It (Islam) not only demands these characteristics in its followers, it also commands the necessary charisma to inspire and change them' (ibid. p. 257).

This moral transformation should not be very costly. The implementing machinery already exits in the form of Mosques and Madrasas, which can be seen even in the remotest villages of most Muslim countries. Along with the social reform organisations, these institutions can be utilised for improving the quality of the people. It is interesting to point out that the Government of Bangladesh have undertaken a programme for training all the *Imams* and *Muazzens* of the country phase by phase. For their effective utilisation, what is needed is, among others, building up appropriate literature for the training.

If the governments come forward and put full weight behind the reform movements, the needed social transformation may not take very long time as one would think of. The effective use of educational institutions and news media may help the governments accelerate the pace of social transformation and help remove the unIslamic social values such as conspicuous consumption and ostentatious ceremonies and pave the way for achieving the increase in the well being of the people.

(ii) Ability

Although establishment of socio-economic justice, creation of social environment and raising of moral consciousness are all necessary to motivate people, they are not enough to realise the level of the desired human welfare. Two persons may be equally motivated but they may not be able to contribute equally to the realisation of human well being. This requires that their abilities should also be raised. For this, the following steps may be suggested.

The most important technique for raising the ability of a person is education and training. Education is regarded as the 'the great equaliser' of human conditions and 'balance wheel of social machinery'. The secularist educational system has, among others:

- failed to make the students better human beings;
- proved unsuccessful in enriching them with the qualities of a true Muslim;
- become unable to raise their responsibilities towards society; and
- also failed to help them acquire the skills in demand.

The education system should be reformed along the lines of its deficiencies as stated above. The primary stress of education should be on creating a 'good' and 'productive' human being. Admissions to vocational training institutes and engineering, and medical colleges should be open to all capable students. Lack of finance should not prevent anybody from seeking higher education. The education system that helps increase the number of 'educated unemployed' should be discouraged. There should be substantial changes in the curricula and inculcate the Islamic values. Particular emphasis will have to be put on female education.

(b) Economic Reforms

For realising the improvement of human well beings expressed in terms of the balanced satisfaction of both the material and the spiritual needs, economic reforms are vitally important. These reforms relate to consumption and investment patterns of both the private and public sectors. Some of the reforms that satisfy the Islamic norms are discussed as under.

(i) Reforms in private consumption patterns

For decades, Muslim countries have been following the Western pattern of consumption, which is characterised by luxurious living and frequency of purchases. This expensive life-style (followed by the richer section) coupled with many unIslamic customs and ceremonies (followed by most) of the Muslim population, extending from childbirth to marriage and death, have led to a consumption pattern that is anything but Islamic. These life-styles have forced the people to either live beyond their means or resort to corruption and unethical means to cover the shortfall between legal income and unrealistic spending. Islamic *Shariah* demands a revolutionary change in these life-styles.

There is a dilemma. In Islamic economics, the objective is to squeeze consumption but at the same time raise capital formation, otherwise the pace of economic development will be hampered.

The crux of the problem is how to distinguish 'necessary' and 'unnecessary' claims on resources, and then how to motivate the people to abstain from making "unnecessary" claims. For the sake of convenience, Chapra divides all goods and services into three categories: needs, luxuries and intermediates. The term 'needs' refers to those goods and services, which fulfil a need or reduce a hardship and thus make a real difference in human well being. It includes both 'necessities' and 'comforts'. The term 'luxuries' refers to those goods and services, which are wanted by the people mainly for their appeal and make no real difference in human well being. The last term 'intermediates', by definition, falls within 'needs' and 'luxuries'. This refers to those goods and services, which can not be classified in either

of the two categories. This, in a sense, provides some flexibility, which is not regarded improper in the eye of Islam. After all, Islam is not an ascetic religion. It allows, as Chapra says, a person to satisfy all his needs and even to go after such comforts as may increase his efficiency and well being. The classification of goods and services must, of course, reflect the environmental conditions, the development of technology and the increase in wealth and general standards of living over time.

Now the question is how to induce and motivate the people to abstain from making claims on luxuries and remain within the orbit of 'necessities and comforts' as defined above. The traditional device is 'price'. That is, if the prices of the luxuries are raised through taxes, tariffs and currency depreciation, people including the rich will reduce their consumption of these commodities. Experience shows that this does not always happen. For instance, in most developing countries, because of inefficient and corrupt tax administration, people find it not difficult to avoid or evade higher tariffs and taxes through such means as under-invoicing, bribery and smuggling. This does not mean that Islam disapproves the operation of market mechanism. It simply means that under special circumstances, the circumstances in which most people have accepted the status symbols and to live beyond legal means as a way of life, price mechanism may not be very effective.

This is the reason, which makes the use Islamic mechanism absolutely necessary. This mechanism is named in the Islamic economics literature as 'Moral Filter' (due to Umer Chapra). This requires the people to understand their obligations and their accountability before Allah and at the same time realise that their use of resources for inessential purposes will definitely deprive others of essential purposes. It is the application of this moral filter that can actually accomplish the necessary changes in the consumer preferences.

In the absence of congenial Islamic environment, it may be necessary to make the campaign for simple living. It may also be necessary at least at the initial stage to impose ban on the luxury goods and services, ostentatious ceremonies, unrealistic dowries and the display of status symbols. The key to success will lie in ensuring that

no one, no matter how rich or influential the person may be, is able to get by. This is the only way through which an authority can strike the root of a corrupt society. The Government of Bangladesh has some interesting experiences about the working of this type measure. It can take revise its action on the basis of these experiences.

For the production, import and distribution of those goods and services falling under the category 'needs', market forces should be allowed to play its constructive role. The government should do all it can to provide the necessary incentives and facilities to increase the supply of these needed goods and services. Indirect tax, if imposed, should be at the lower rate and be graduated in the reverse order of their priority. The consumption of goods falling under the category 'intermediates' should be discouraged through higher taxes or tariffs. It would be necessary not to liberalise the luxury goods and services.

All these measures should, of course, reflect the stage of development of the countries concerned.

(ii) Reforms in public finances

Measures suggested above, if implemented, will go a long way in reducing and increasing savings needed for capital formation. Along with these, government expenditures will also have to be streamlined. The governments of developing countries are known to make excessive claims on resources. In spite of these claims, the vital sectors of the economy have remained basically neglected. The physical infrastructures including the rural infrastructures and agricultural extension services, education including human character building, health including safe drinking water, sanitary services and eradication of malnutrition, housing including those of the poor, and the like, have remained underdeveloped. It is, therefore, necessary not only to reduce unnecessary expenditures but also to concentrate more projects that will help accelerate development and improve the overall human well being.

Against this background, some suggestions from an Islamic perspective are given both for reducing spending and for increasing revenues.

Suggestions for Reducing Government Spending

First, the most obvious way to achieve substantial savings (and hence reducing government spending) is to minimise (if not eradicate) corruption, inefficiency and waste. These are seriously eroding the government's ability to utilise its scarce resources efficiently. Some examples may be: big loans extended by nationalised banks to influential persons being written off; thousands and thousands of small agricultural loans being written off just to gain political support just before national elections; expensive roads being washed away by a single rainstorm; imported machinery being sold before arriving in the country; monuments being erected in the name of the persons belonging to the party in power: and so on and so forth.

The efforts to reduce corruption will not succeed unless accompanied by, among others as discussed elsewhere in this chapter, moral reforms. The governments must realise the Islamic value that 'the resources at their disposal are a trust from Allah'. These must be utilised only in the ways that increase the well being of the people.

Secondly, a second area where savings can be made by eliminating subsidies given basically on political consideration. Subsidies given for the reason of alleviation of poverty can obviously be supported; but in most developing countries, the results are not very encouraging.

One of the goals for which subsidy is given is to increase the efficiency of the recipients. Experience shows that subsidy given in the agricultural sector has helped mainly the big farmers who have used this benefit for purchasing lands. The subsidy paid to large-scale urban industries on the basis of the 'infant industry' argument has rarely encouraged them to cross the threshold of 'infancy'. Subsidy has also failed to produce redistributive effect, its benefits have been distributed unequally between the rich and the poor.

It is, therefore, suggested that the poor should be helped through other means such as direct transfer payments made out of, say, *Zakat* funds and other voluntary and compulsory donations.

Thirdly, perhaps the most important area where substantial saving could be made is lifting of patronage provided to the public

sector enterprises. Experience shows that in the third world countries (including Bangladesh), by and large the performance of state-owned enterprises has been anything but disappointing.[4] The step taken by the Government of Bangladesh in this regard (i.e., selling of losing public enterprises to the private sector) is justified on this count.

Fourthly, still another area of reducing government spending is defence. Many developing countries, including Muslim ones, have been spending huge sums of money on defence. Bangladesh is no exception. It should be understood that high military expenditure imposes not only huge monetary costs but also other costs, including reduced well being of the general masses, leading to social unrest and political instability. According to the World Bank Report 1988 (p. 106), 'evidence increasingly points to high military spending as contributing to fiscal and debt crises, complicating stabilisation and adjustment, and negatively affecting economic growth and development'. Chapra is right when he says, ' High defence spending does not even provide the security, which the governments claim it does. The 'real' source of security for the poorer Muslim countries lies in internal strength attained through moral reform, economic development and socio-economic jùstice' (Ibid. p. 294). It is, therefore, strongly suggested that, unless the country is under direct threat from its neighbouring countries, defence expenditure should be gradually reduced to a minimum.

Suggestions for Increasing Government Revenues

First, *Zakat* can be an important source of government revenue. If properly collected, it can contribute some 3 to 4 per cent of the GDP every year. Only a few countries (e.g. Pakistan, Malaysia and Saudi Arabia) have so far made attempts to collect *Zakat* formally. The funds thus collected can be used for providing opportunities for the poor but diligent people for standing on their own legs.

Secondly, taxation is certainly an important source of revenue of all developing countries including the Muslim ones. The amount of

[4] For source see Chapra (1992, 293).

revenue collected is, however, very low in most countries when compared to their neighbours. Direct taxes contribute only a small proportion of tax revenues, making the tax system regressive in character. In Bangladesh. tax revenue constitutes only 9.6% of the total revenue in 1995 in comparison to 20.6% in Malaysia in the same year.[5] The number of tax assessees is small and there are a large number of deductions and exemptions. This makes the tax base narrow and the tax system inelastic in nature. The narrow tax base, in turn, necessitates high tax rates, which again, in turn, induces evasion and black money. Low tax base, high tax rates and the consequent inducement to tax evasion and generation of black money all constitute parts of the 'Vicious Circle'. This vicious circle must be broken. Reliance on indirect taxes should be reduced. The reform of the tax system requires: the number of assesses should be enlarged; most of the unnecessary exemptions and deductions should be eliminated; and the tax rates should be rationalised. Given the political will, this should not be an impossible task.

Thirdly, borrowing has now become a very vital source of government finance in almost all developing Muslim countries. Not only for financing development projects, these countries sometimes borrow even for financing current expenditure. This type of finance ultimately leads to higher inflation, greater currency depreciation, balance of payments deficits, and an even higher debt-servicing burden. It is, therefore, suggested that this source of finance should be used only when it is absolutely necessary for the improvement of human welfare.

It will be advisable to try to finance by alternative mechanisms permitted by the *Shariah.* One such mechanism is leasing. Infrastructure projects can be financed and implemented by the private sector on a competitive basis in accordance with government specifications. This will contribute to greater efficiency and less corruption. The government can also arrange some of the financing on the basis of instalment, deferred-payment and hire-purchase. It may

[5] For details, see Chapter 15.

invite private sector participation in the equity of projects, which are commercially viable.

Moreover, the government can encourage private philanthropists to come forward to construct and run as many as possible of the educational institutions, hospitals, housing schemes for the poor, orphanages and other social service projects. The institution of *Awqaf* can play a very important role in the filed of financing. Incidentally, it may be noted that the SIBL has made an attempt to activise this institution, although its application is still very limited.

It should be remembered that borrowing involves interest, which is forbidden in Islam. There are, however, some Islamic economists, who support conventional borrowing, that is, borrowing in terms of interest, only under very special circumstances. As Chapra says, 'In extremely difficult circumstances, when the spending is considered indispensable in the overall public interest and the financing can not be raised otherwise, it may be juristically permissible for a Muslim government to resort to conventional borrowing' (*Ibid.* p. 302).[6] The IDB can play a dominant role in providing financial assistance based on Islamic instruments. It is of course always desirable to avoid borrowing: 'the hand that is above is better than the hand that is below' **(Bukhari).**

(iii) Improving investment climate

One of the important ways of promoting development, need-fulfilment and employment is increased investment. Experience

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[6] This opinion is based on the Quranic verse related to certain specified items which have been prohibited but the use of which has been allowed in extremely dire circumstances. **'He has forbidden carrion, blood, pork and that which has been slaughtered in the name other than Allah. However, if one is forced by dire necessity without wilful disobedience or transgression of the limit, no sin shall be on him. Certainly, Allah is Forgiven and Kind' [Baqara 2:173].** This principle is applied by way of analogy to interest paid if there is a dire need for funds and no other alternative arrangement is possible, provided that the borrowing is resorted to only to the extent absolutely necessary. (Chapra 1992, p. 322). In effect, the Islamic jurists have formulated an important principle, namely, that 'necessity removes restrictions' (see Qaradawi 1960, p. 37).

indicates that a substantial part of the savings in most developing countries goes to unproductive channels such as hoarding in the form of gold, jewellery and precious stones and capital flight. This will have to be stopped by creating appropriate investment climate within the country. Some suggestions are given below in this regard.

First, adequate social and physical infrastructure facilities will have to be created. These would include roads, buildings, agricultural extension services, education, health, housing and transport system.

Secondly, the inefficient and corrupt tax system should be reformed in the ways described in the previous section.

Thirdly, political uncertainties generate fears about sudden changes in official policies, which may contribute backbreaking losses. Islam supports democratic process while making policies. The *Shariah* clearly defines the rights and responsibilities of the state. It can not arbitrarily nationalise private properties. 'Your lives and your properties are as sacrade as this day of the *Hajj*' was the part of the address made by the Prophet on the occasion of his farewell pilgrimage. From this the Islamic jurists have formed the maxim that 'The ruler has no right to expropriate anything except by an established and known right'. If it is absolutely necessary to nationalise any private property, *Shariah* demands that fair compensation must be paid to the real owners. These guarantees will need to be integrated in the country's constitution and legal framework. Moreover, it should be the moral responsibility of the ruling political party and the party (or parties) in opposition to the consensus regarding frequent and avoidable national strikes and lock-outs due to labour unrest. After all political stability is a precondition for economic stability.

Fourthly, perhaps the most serious obstacle to investment in the developing Muslim world including Bangladesh is bureaucratic red tape. This springs from various types of controls. Controls are an inevitable source of corruption and lead to unnecessary rise in costs. The general spirit of Islamic teaching is freedom of enterprise within the value-frame of Islam. For creating proper investment climate, it will be necessary to remove most of the controls, if not all.

Fifthly, in the field of international trade, several reforms are necessary. Exchange controls (overvalued exchange rates with licensing) practised in many countries have been largely ineffective. High tariffs, if applied effectively, can discourage unnecessary imports provided the customs administration is free from corruption. Moral reforms will therefore be necessary. At the preliminary stage, it would be advisable to ban import of luxury goods altogether. Import-promotion industries may be encouraged. Choice of industries would be very important in this case. Instead of encouraging large-scale industries with capital-intensive or sophisticated technology, it would be desirable to emphasise labour on intensive, small and micro industries in the rural and urban areas. This will help create more employment and at the same time help maximise human welfare with distributive justice.

Sixthly, the Islamic ban on interest will make it indispensable for Muslim countries to look for alternative mode. According to the World Development Report 1985 (p. 125), investment on the basis of equity has already proved to be beneficial for the developing countries and that it should be possible to attract it by creating favourable climate for it. Foreign equity capital is advantageous on many counts. The most important ones are that it makes available scarce foreign exchange as well as technology and management in the host counties. For this, of course, it will be necessary to provide the necessary incentives and facilities to the foreign investors. The Islamic emphasis on the fulfilment of the contractual obligations, if articulated legally, should provide reassurance that they need very much. The removal of exchange controls and assurance about capital repatriation, all falling within the value frame, would go a long way in attracting foreign capital.

(iv) Re-fixing production priorities

Reforming the investment climate would help increase in the volume of investments. Unless other complementary measures are taken the increased investments may be diverted to luxury and non-essential goods and services. Rather than imposing controls, it would be advisable to make an attempt to change the individual preferences

by motivating them morally and socially. All obstacles and controls meant for the production of essential goods should be withdrawn. The industrialists should be discouraged to produce non-essential goods and services while the demand for essential goods and services remain unfulfilled. Under normal circumstances, price control measures should be done away with. Price controls can be justified only to meet emergencies or to control artificial and harmful monopoly, collusion or hoarding. All efforts should be made to support agriculture and rural development.

In passing it may be of some interest to point out that Islam encourages both agricultural and non-agricultural activities. Which sector should get priority over the other depends upon the circumstances of the countries concerned. According to Qaradawi, 'Agriculture is essential, and Islam persuades people to engage in it by pointing to the benefits in this world, and the reward in the Hereafter resulting from it. However, from the Islamic point of view, it would be extremely undesirable if people limited their economic efforts solely to agriculture, a situation analogous to supposing that the inexhaustible oceans had no use other than the extraction of pearls from their depths' (Qaradawi 1960, p. 130).[7] In addition to agriculture, the Muslim countries must develop industries, crafts and professions as are essential for a free and powerful nation. For the interest of the developing countries we are referring to, it would of course be advisable to give emphasis on small scale and cottage industries rather than large scale and luxurious industries.

(v) Reforms in the agriculture and rural sector

First, the obstacles standing on the way to agriculture and rural development should be removed. Necessary provision in the national budget should be made for the construction of infrastructure facilities including irrigation and drainage, extension services, roads, schools, electricity, housing and health. Artificial lowering of agricultural prices depress rural income and prevents rural farmers

[7] See also Chapter 2, Sections 5.

from undertaking necessary investments in improved seeds and tools, fertilisers, irrigation, pesticides, better storage facilities as well as in small and micro industries. This needs immediate correction.

Secondly, lack of access to financial resources is another vital constraint. This forces them to resort to traditional sources of financing i.e., money-lenders, who are known to charge extremely high rate of interest. Necessary arrangements will have to be made to provide adequate finances to the rural people not only for increasing agricultural production but also for establishing small and cottage industries in the rural areas.

(vi) Promoting small and micro enterprises

As noted above, improvement of human welfare can not be effectively made unless and until the human beings are given the opportunity to utilise their creative and artistic abilities to their fullest extent. This would be possible only when they are provided with the opportunities to become self-employed. To make them self-employed would require the promotion of small and micro enterprises. Some necessary steps in this regard are suggested below.

First, the rural entrepreneurs should be helped in obtaining the necessary inputs required for increasing agricultural productivity and for establishing micro industries.

Secondly, they must be provided with necessary access to finance based on the principles of the *Shariah.*

Thirdly, they should be given the opportunities and facilities to improve their skills through training and retraining. For this, it would be necessary to establish appropriate training institutions and prepare appropriate training modules. The experiences of the Grameen Bank can be of much help in this regard.

Fourthly, there must be a change in the official attitude and policies towards the rural farmers and small entrepreneurs. All policies acting against them must be redirected.

Fifthly, all these must be accompanied by a change in life-styles away from the Western status symbols to simple but adjusted to suit domestically produced goods and services.

(c) Distributive Reforms

The most serious obstacle to the realisation of the goals of the *Shariah*, i.e. improvement of human well beings, is the existing concentration in ownership of the means of production in a few hands. Undoubtedly, this is a matter of concern not only in the Islamic countries but also in the non-Islamic ones. But the ways through which this is expected to be accomplished in non-Islamic world is not either desirable or meaningful. For instance, in the socialistic society, in the name of removing distributional injustice, the human beings have been made permanent wage-slaves and their initiative and enterprise have been killed through following the centralised decision-making system. The capitalistic system thinks that the equity would come automatically once economic growth takes place. It is now anybody's guess that this has not happened. This implies that there are some measures, which are missing from the agenda of both the capitalistic and socialistic societies. The following sections would try to identify the measures needed for reducing concentration of wealth in a few hands.

(i) Land reforms

In the agricultural countries such as Bangladesh and Pakistan, land serves not only as a major source of income of the vast majority of the people but also as a source of political power. In many land-scarce countries, cultivable lands are unequally distributed. The number of landless and near-landless people is continuously on the increase. In Bangladesh, these people constitute not less than two-third of the total population. It will not be possible to uplift the socio-economic well being of the general masses unless and until the power centres of the rural areas are diluted.

The question of land reforms centres round three basic issues namely, size of holdings, tenancy systems and absentee landlordism. Policy issues in connection with these are discussed below.

Size of holdings: Under normal circumstances, Islamic *Shariah* does not visualise the setting of any limit on private wealth such as land. Unlimited ownership of landholdings can be justified on the following conditions:

- Lands have been acquired through legal means,

- Lands are properly utilised,
- Lands are leased out on just terms and conditions,
- Landlords, having excessive amount of land, do not act as the money-lenders, who are known to charge sky-high rate of interest from the poor and landless,
- Islamic law of inheritance is not disregarded, and, most importantly,
- Landholdings are not inequitably distributed among the farming people.

In case these conditions are violated, the Islamic government has the right to take any measure relating to the limit of the size of landholdings. Experience shows that in most Muslim countries, most of these conditions are violated. In effect the maldistribution of land has become an important determinant of the unequal distribution of income and the incidence of poverty. This, necessitates the interference by the government in the size of holdings. It is, therefore, suggested that the size of holdings should be reduced. For a country like Bangladesh, this limit may be around 15 acres in comparison to theoretical limit of 20 acres at present. It should, however, be borne in mind that the limit of landholdings must not be below what is called 'economic holdings'. The size of economic holding would of course depend upon a host of factors including productivity of the land and nearness of the land to the urban areas.

The excess lands obtained through the implementation of the land reform measures should be distributed among the real cultivators, who have either no land of their own or have lands, which are too small to give a source of living. Islamic *Shariah* requires that the lands taken should be properly compensated to the 'rightful' owners. The *Shariah* also requires that the lands should not be given to the needed people completely free. Chapra opines that a fair price will have to be fixed and the entire value will have to be realised by the government gradually over a number of years out of the peasants' earnings (ibid. p. 265). This money can be used to pay compensation to the original rightful owners.

A word may be added about the viability of the small size of holdings as suggested above. It is sometimes argued that small sizes of

holdings make the agricultural sector inefficient. Referring to empirical studies of different countries, Chapra (ibid. p. 268) shows that farm size and output are inversely correlated. In other words, small farms are more efficient than large farms. The World Bank also remarks that 'the resilience and productivity of small family farms throughout the world is striking' especially in view of the considerable disadvantages faced by the small farmers in terms of limited access to services, markets and productive inputs such as fertilisers and irrigation water. Countries that have combined economic growth with an equitable distribution of landholdings include Japan, Taiwan, South Korea and Costa Rica. (*Ibid.* pp. 267-68).

Tenancy systems: Like size of holdings, tenancy system may also have important impact on the concentration of income and wealth. Two types of tenancy are generally seen in the predominantly agricultural countries. These are share-cropping system and fixed-rent system.

Unfortunately, *Fiqh* literature is full of controversy regarding the very permissibility of the tenancy system (irrespective of its forms) in Islam. In spite this controversy, I would agree with the summary view of Chapra, i.e.:

> 'A predominant majority of the jurists, however, allow both share-cropping and fixed-rent tenancy, this being consistent with the permissibility of both *mudarabah* and leasing in the *Shariah.* Their rationale is that the poverty of most Muslims in the early Madinan period had led the Prophet, may the peace and blessings of God be on him, to be more demanding on the rich. He hence discouraged both share-cropping and fixed-rent tenancy, and encouraged landlords to allow the peasants to cultivate, without paying any compensation, whatever lands the landlords could not cultivate themselves. However, later on when the economic condition of Muslims improved, he allowed both, and not just share-cropping as is argued....' (ibid. p. 266).

However, since tenants and landless farmers are weak and powerless, the prevailing tenancy systems may serve as a source of injustice and poverty. This will happen when rents are high and outputs are uncertain and the share-croppers are to pay half of the share of output (say) bearing all costs of production themselves.

Therefore, some reforms would be needed from the viewpoint of reduction of the concentration of income and wealth in the rural settings.

For share-cropping system, it will be necessary to ensure that the share-tenants get fair share of the output after deducting the costs of production. In this case, it would be worthwhile to note the measures undertaken by the Government of Bangladesh. In its 1984 Land Reforms Ordinance, the output is supposed to be divided into three shares. One share is taken by the landlord as a rent for his land, another one is taken by the share-cropper for his labour and the third share is taken by that party who bears the costs of fertilisers, irrigation water and insecticides. The sharing contract is also guaranteed for five years. If sincerely implemented, this would surely go a long way to ensure fair justice to the share-croppers.

But what about the fixed-rent system? Incidentally, the Government of Bangladesh has so far taken no steps in this regard. Maliki School of Thought gives one suggestion. This is that if the output gets destroyed or the lessee is unable to cultivate the leased land due to circumstances beyond his control (e.g., flood or drought), then the lease contract becomes violable because of excessive risk and uncertainty (*Gharar)*. Whether this suggestion is accepted totally or not, the importance of a measure along this line can not be overlooked.

Absentee lanlordism: In many agriculturally dominated countries, it is found that some persons possessing large tracts of land do not stay there but stay in other areas or cities and get themselves engaged either in business or in salaried jobs. They lease out their lands either on share-cropping system or fixed-rent system. They do not supervise their lands. The lands are left entirely at the mercy of the cultivators. Normally they visit their lands once (or at best twice) in a year just to collect the share of their outputs or the rent contracted. They are by definition absentee landlords. Experience of Bangladesh shows that lands falling under the system never get properly utilised. Islamic *Shariah* demands that for the sake of optimum utilisation of the Allah-given resources, these lands should be taken up by the government after giving fair compensation to their real owners and distribute them among the landless cultivating farmers.

(ii) Encouraging small and micro-enterprises

For the reduction of the concentration of income and wealth, measures relating to the agricultural sector are not enough. In order to supplement these measures the unequal distribution seen in the industrial sectors should also be dealt with. In the capitalist world, large businesses dominate the economic and political scene. It is apprehended that monopoly or oligopoly may take the leadership in the 21st century in this society. Concentration of computer manufacturing basically in one or two firms may be an example in point.

This suggests that the small and micro enterprises of the rural and urban sectors should be encouraged. This particular emphasis on the small and micro sectors occupies a very high place in the Islamic value frame. Apart from reducing concentration of wealth, this improves social health because ownership of businesses tends to increase the owners' sense of independence, dignity and self-respect. It would also help the entrepreneurs innovate and work harder for the success of their business. Greater efficiency would also be attained.

(iii) Wider ownership and control of corporations

The suggestion for encouraging the small and the micro enterprises does not mean that Islam discourages large enterprises There is nothing wrong if large enterprises do not lead to excessive concentration of income and wealth. From Islamic point of view, it is more preferable to choose the corporate form of business organisation for large enterprises whenever they are necessary. The type of corporations found in the Western world are not desirable. In this society these corporations operate as autocratic institutions; the holding of controlling stock by a few families makes it possible to have control over all policies. This is also the result of the interest-based system. The abolition of interest and a substantial expansion of equity in the capital structure of corporations would lead to minimise the leverage of rich families. This would also lead to wider ownership of corporate shares and thus lead to equitable distribution of power. In order to open up the opportunity of wider participation in the decision making other forms of reforms would also be necessary.

(iv) Activation of *Zakat*

Apart from the traditional measures, Islam has incorporated in its structure of beliefs an arrangement for the reduction of the concentration of income and wealth through *Zakat* (and other forms of compulsory and voluntary contributions from the richer section of the society to the poor).

Zakat is a compulsory payment, made by the people having an amount of wealth above *Nisab*. It is regarded as one of the pillars of Islam.[8] It is not to be confused with tax, which is also a compulsory payment. There is a fundamental difference: the civil authority imposes the latter but Allah Himself imposes the former. Therefore, the payment of *Zakat* by the rich should not be regarded as a favour of the rich to the poor. While it is the duty of the true Muslim to pay it, it is the right of the poor to receive it. **'And in their wealth the beggar and the outcast had due share' [Zariyat 51:19].** It should also be borne in mind that *Zakat* does not replace taxes. Taxes have other functions to perform.[9]

If *Zakat* is properly collected and distributed, it will have tremendous impact on the distribution of income and wealth in the society. It can be used for enabling the poor to stand on their own legs; it can provide a permanent income supplement for those who can not earn sufficient income for their families; it can help increase the funds for investment; it would discourage extravagance of those who have excessive wealth; and, it would also discourage the hoarding of wealth in the form of gold and silver. For institutionalising the *Zakat*, the state would have to play a pertinent role.

(v) Activation of the law of inheritance

Another measure instituted by the Quran and the *Sunnah* is the law of inheritance. If properly implemented, it can produce positive impact on the distribution of income and wealth in the society. Some of the basic features of the law relevant for the purpose we have in hand are shown below.

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[8] For a detailed discussion on *Zakat*, see Chapter 14.

[9] See Chapter 15 for details.

- Every Muslim is under obligation to distribute his property according to the rules specified by the *Shariah;*
- No one can make a will for more than one-third of his estate. This share has to be for charitable objectives or for persons not already entitled to a share in the estate (unless the other heirs agree);
- Both the living parents of the deceased are assured of a prescribed share; this not only ensures their welfare but also enables the distribution of the parent's share to the brothers and sisters of the deceased after the parent's death, thus generating a wider distribution of wealth;
- The wife is assured of a prescribed share; and
- The balance goes to all the children of the deceased.

(d) Financial Reforms

Financing is a powerful economic, social and political weapon in the modern world. It plays a vital role not only in the efficient allocation and distribution of scarce resources, but also in the stability and growth in the economy. It provides power base and social status for the people. Therefore, no programme would be successful unless and until necessary financial reforms are made and executed simultaneously in the economy.

There are two objectives behind these financial reforms namely: (i) to finance an optimum number of enterprises, and (ii) to finance production, distribution and imports of the goods and services so as to satisfy the needs of all the members of the society.

From an Islamic perspective, two reforms are suggested as discussed below.

(i) Equitable but Islamic financial intermediaries

The conventional interest-based financial intermediaries are not equitable. This is now a universally accepted fact. Traditional economic literature abounds with examples which lend support to this assertion. For example, Bigsten says, 'the distribution of capital is even more unequal than that of land' and 'the banking system tends to reinforce the unequal distribution of capital' (Bigsten 1987, p. 156).

This unequal distribution not only refers to different classes of people but also to different types of activities as well as different regions. The U.S. House of Representatives in its *Report of Select Committee on Hunger* (1986, p. v) points out that 'formal financial institutions in these (developing) countries do not recognise the viability of income-generating enterprises owned by the poor'. The suggested reforms would include the following.

The financial intermediaries will have to shift their emphasis from large credit to micro-credit, from large firms to small firms, from urban areas to rural areas, from rich to poor. One fear usually stands on the way of this type of shifting policy even for the financial institutions, which are committed to help the poor. This relates to the greater risk and expense to which the commercial banks are exposed. We must do something about this type of genuine concern.

In the first place, given the practical experiences of Grameen Bank and similar other NGOs in Bangladesh, the fear of this type of risk would appear to be baseless. These institutions are giving loans to the small enterprises, to the poorest of the poor of rural areas and their repayment records are very much satisfactory. The rate of repayment is usually over 95 per cent. On the basis of this experience, the said *Select Committee on Hunger* also categorically states that:

> 'the provisions of small amounts of credit to micro-enterprises in the informal sector of the economy of developing countries can significantly raise the living standards of the poor, increase food security, and bring about substantial improvements of the local economies.' The Committee also concludes that 'making credit available to entry level micro entrepreneurs is one way to help the cycle of poverty and hunger among urban and rural landless poor in developing countries' (p.v).

Yunus systematically emphasises that for financing self-employment micro-credit should be 'recognised as a right that plays a critical role in attaining all other rights' (Yunus 1987). He also shows that the poor are not poor because of their unwillingness to work hard but because they are denied of the access to financial resources necessary for self-employment. In a sense, it is shown, the poor work harder than the rich and have more skill than they normally can make use of.

What we are searching here is an equitable but Islamic intermediary. Grameen bank type models can be regarded as equitable but not necessarily Islamic. In these institutions 'almost' all operations are carried out on the basis of interest, which is condemned in Islam. This necessitates a fundamental reform of the mode of operation of the traditional Grameen model. That is, **interest should be replaced by the PLS system**. This would be a very important change in the financial policy.

The adoption of the Islamic financial system is said to be more conducive to the suggested reform. As Chapra says, 'The sharing of risks along with rewards by the financial institutions would substantially reduce the precariousness of a small entrepreneur's position - he would save himself from the back-breaking burden of interest in difficult times by his willingness to pay a higher rate of return in good times' (Chapra 1992, p. 329).

The suggested reform will have to face an additional problem. Financial assistance will have to be provided without any collateral. Grameen bank-type institutions do not take any collateral. But their risk is relatively lower in that they charge a prefixed amount of charge in the form of interest. The suggested Islamic intermediary can not do so. It will have to share the risk of profit and loss with the clients. Incidentally, the Islamic banks of Bangladesh and other countries have not yet ventured to take this type of risk in their business arena.

Chapra has suggested an interesting way out. This is the introduction of what is called **'Loan Guarantee Scheme' (LGS).** For this, he makes a distinction between two types of risks namely, business risk and moral risk. 'Business risks' are defined as those risks which occur due to market failure and 'moral risks' are those which occur due to immoral actions on the part of the parties concerned. It is maintained that the LGS will bear only the moral risks, not the business risks. The business risks are said to be borne by the bank and the clients according to their pre-agreed ratio. The government and the commercial banks concerned can jointly underwrite the LGS. The scheme would examine and certify the credentials of the projects submitted for financing. Some of the costs involved in these

operations may be partly borne by the government and partly by the banks for the interest of the poor and the needy. It is expected that once the credentials of the micro-enterprises are established, and the system starts operating, the costs to be shared by the government may go down.

There still remains doubt as to why should the proposed institutions at all go in for so much risk and uncertainty if they are not profitable enough. In effect, this is one of important reasons for which the financial institutions have shown apathy towards the small enterprises so far. However, given the experiences we have in the development literature, this doubt would seem to be unfounded too. The Grameen Bank has proved beyond doubt that financing the poor is not necessarily a losing concern. If sufficient care can be taken in selecting and guiding the entrepreneurs, it is very much possible to make profit out of it. A study of Michigan State University, as noted by Chapra, clearly shows that the economic profit of smaller firms are consistently larger than that of large firms (*Ibid.* p. 330). On the basis of experiences gained from different countries, the International Fund for Agricultural Development (IFAD) notes that the credit provided to the most enterprising of the poor is quickly repaid by them from their higher earnings. (*Ibid.* p. 331).

(ii) Efficient but Islamic financial intermediaries

The traditional financial intermediaries are inefficient by any standard criteria. Since these are assured of fixed amount of income in the form of interest, they do not normally look into the viability of the projects submitted for financing. They do not see whether the credit will ultimately be used for productive purposes or simply used for conspicuous consumption. Certainly, the credit that dose not lead to optimum investment and need satisfaction because of its diversion to unproductive uses must be regarded as inefficient.

In the Islamic financial system involving risk and reward, both value judgements and strength of the proposals are considered while allocating resources. This will have to be so because if the proposals are not properly evaluated, the financial institution will have to face

greater risk in realising the money. This, in a sense, acts as the filter mechanism through which the bad projects are identified and are thrown away. In the Islamic system, the filter mechanism would also work on the demand side. The projects submitted would normally involve those goods and services, which are essential or at least are within the 'comfort' category.

Thus if the proposed reforms get implemented, overflow of credit for unproductive and/or luxury purposes would be greatly reduced and thus would make a healthy contribution to the removal of imbalances and the realisation of both equity and efficiency. These suggested reforms would also help bring into the folds of the Islamic financial intermediaries untapped savings of the large number of rural people. In other words, this would help mobilise the idle savings in the economy and thus would generate a non-inflationary rate of growth. It may also help reduce the attractiveness of gold as a store of value and release savings for productive investment through the financial intermediaries.

REFERENCES FOR FURTHER READING[10]

1. M. Umer Chapra (1992), 2. Shah Muhammad Habibur Rahman (1996).

[10] For details see the list of references given at the end of the Book.

APPENDIX

"Anti-Islamic forces in the world, particularly in America have a vision to defeat Islam worldwide as a *deen* and render it permanently to a personal religion of rituals only. Are we, the informed Muslims, going to allow it to happen or are we going to have a vision of the world through the eyes of Islam?" -THE VISION, IIIE, USA.

"WOULD THEY DESIRE TO PUT OUT THE LIGHT OF ALLAH WITH THEIR MOUTHS ! BUT ALLAH WILL PERFECT HIS LIGHT, HOWEVER MUCH THE DISBELIEVERS MAY HATE" [SAF 61:8].

"YOU ARE THE BEST *UMMAH* THAT HAS BEEN RAISED UP FOR HUMANKIND. YOU ENJOIN WHAT IS RIGHT, FORBID WHAT IS WRONG AND BELIEVE IN ALLAH" [AL-IMRAN 3:110].

TODAY'S PROBLEMS, TOMORROW'S SOLUTIONS : THE FUTURE OF ISLAMIC ECONOMICS

Appendix

TODAY'S PROBLEMS, TOMORROW'S SOLUTIONS : THE FUTURE OF ISLAMIC ECONOMICS

1. Today's Problems : Background of this Chapter

During my three months' stay at Dallas (Texas, USA), I aggressively searched through the Internet the relevant materials for upgrading the Book. Among the references I came across through the internet, some appeared to have been written against the "spread of *Islamist* economics teachings and practices". I chose two research papers of one Economics Professor of the University of Southern California and requested him by email to send me the originals. The kind-hearted Professor quickly responded to my request and I got the papers within a week or so. The first paper entitled "The Economic Impact of Islamic Fundamentalism" was published in 1993 in Martin Marty and R. Scott Appleby (eds.), *Fundamentalisms and the State: Ranking Polities, Economies, and Militance*, Chicago University Press, pp. 302-341.[1] The paper is of very high quality and contains a large number of references (127 footnotes with innumerable references) of both the Muslim and non-Muslim authors. Almost all the statements made in the paper are referred. The study led the author to conclude, among others, as follows:

> "My evaluation thus indicates that by its own lofty yardstick Islamic economics is a failure" (p.307).

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[1] The study was funded by the National Endowment for the Humanities and the Faculty Research and Innovative Fund of the University of Southern California.

Again:

> "The twenty-first century could thus become for Islam what the twentieth was for socialism: a period of infinite hope and promise, followed by disappointment, repression, disillusionment, and despair" (p.332).

My own chosen second paper entitled "Islamism and Economics: Policy Implications for a Free Society" was published, four years later in 1997 in the *International Review of Comparative Public Policy*, Volume 9, pp.71-102. Having analysed very extensively, the author opines that if a society run by *Islamists* perform poorly in an economic sense, other societies will suffer. He went on:

> "The economically backward societies will accumulate resentments against the global economic system, against advanced societies, and even against similarly disadvantaged others. Such resentments can become a source of international friction" (p.86).

And hence in order to meet the challenge of Islamic economics, he suggests three classes of prescriptions:

> "In the first place, one must expose the flaws and limitations of Islamic economics. Secondly, one needs to show the economic prescriptions of Islamists have considerably less appeal than their leaders tend to claim. Finally, it is essential to devise creative solutions to the festering socioeconomic problems that have fueled the rise of Islamism" (p.87)

Against the background, this appendix, "Today's Problems, Tomorrow's Solutions: The Future of Islamic Economics" is written. The intention here is to open a meaningful dialogue about the role of Islamic economics among the scholars, both Islamic and secular.[2]

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[2] **Note**: the author of both these papers is Dr. Timur Kuran, Professor of Economics and King Faisal Professor of Islamic Thought and Culture, University of Southern California, USA. To see his writings through internet, contact http://www.usc.edu/dept/LAS/economics/Faculty/Kuran/cv.htm ; his email address is: kuran@rcf.usc.edu . Between 1993 and 1997, he has published 5 more articles which deal with the "flaws" of Islamic economics.

2. *Riba*-interest controversy may remain as an academic exercise in the future, but the ban of *riba* will remain forever

The Quranic ban of *Riba* (or interest), I am highly convinced, is one of the pillars of Islamic economics, not to mention the case of Islamic banking. But the literature, whether we accept it or not, is still beset with controversy of a very high level, whether *Riba* and interest are the same thing. My extensive reading of the literature forced me to believe that whilst 'elimination of *Riba*' from the economy is the greatest plus point for popularising the discipline; at the same time, the treatment of 'interest as *Riba*' is the severest obstacle on the way of its acceptability not only among the non-Muslim economists but also among the Muslim ones. We must find out tomorrow's solution for this today's problem.

First of all, we should listen to what they actually want to say. One opinion:

> "What the Quran bans unambiguously is the pre-Islamic Arabian institution of *riba*, wherby a borrower saw his debt double following a default and redouble if he defaulted again. Because it tended to push defaulters into enslavement, *riba* had long been a source of communal friction. The purpose of the ban was undoubtedly to forestall communal disharmony by curbing, in the spirit of a modern bankruptcy law, the penalty for default. This is supported by the fact that the Quranic verses banning riba tend to show compassion toward borrowers in distress and to refrain from taking advantage of their misfortunes. The ban on riba may be interpreted, then, as an injunction against kicking a person when he is down" (1993, p. 314).[3] Perhaps, the most extreme view is given by Suleyman Uludag, when he is reported as saying, "Those who insist on banning interest are ignorant, he says, of Islamic history and guilty of misinterpreting the Quran, which bans not interest but usury, or exorbitant interest. ...This, he says, is a serious crime against Islam, a religion that stands for truthfulness" (1993, p.315).

Against these opinions, what is our standpoint? The Quran is silent about the exact meaning of the term *Riba*, perhaps because of

[3] In this chapter, all references, unless otherwise stated, are from the two studies of T. Kuran as mentioned in the text.

the fact that its rationale may vary from period to period and from region to region. The *Hadiths* are also not as clear and specific as many would strive to make us believe. Abdullah Yusuf Ali and Muhammad Pickthal (both are renowned Quraŋ translators) appear to agree on the view as expressed by Uludag when they use the word "Usury" for "*Riba*". M. A. Mannan in his most publicised treatise (1970) categorically says that the difference between *Riba* and interest is not of kind, but of degree, that is, "exorbitant rate of interest". Later, it is through the writings of such eminent islamic economists as Umer Chapra (1985) that it becomes absolutely clear that, in accordance with the consensus of all jurists, *Riba* has the same meaning and import as "interest".

This Quranic ban of *Riba* (and, hence, interest) is being implemented through the operation of what is known as "Islamic banking". Let us admit that most of the developing Muslim countries are to depend very heavily upon the non-Mulsim developed countries for external finance. These countries (at this stage) are not going to lend money without resorting to *Riba*/interest. This led the Islamic jurists to allow the Muslim governments to borrow on the basis of interest (at least temporarily) on the basis of the Quranic verse **[Baqara 2:173]**, related to certain specified items which have been prohibited but the use of which has been allowed in extremely dire circumstances. This may be treated as an analogy (*Qiyas*) which is allowed in Islam.

This special measure has in fact encouraged many critics of Islamic economics to remark, for example. "Sensing that it may never be practical to do away with interest....onetime believers in Islamic economics begin chipping away at its edifice. At first they transformed only the practice, resorting to many ruses. Then they begin altering the theory openly – for example, by re-defining interest...." (1993, p.333).

It is now anybody's guess that the above-noted comment, when read against the scenario as described above, would appear to be clearly baseless. The proposed exemption is connected with external borrowing only, in which case the poor Muslim country may not have any control whatsoever over the non-Muslim lending country. The ban

on "usury" (interest) within the country and between Muslim countries stand valid. and would remain valid as an Islamic strategy for all time to come. Therefore. Islamic economics. as a new discipline. has not chipped away at its edifice. Its unique stand for creating a *Riba*-free economy, that is. an economy free from all sorts of exploitation and injustice, remain clear and unambiguous. Whether today's "interest" can capture the exact meaning of the Quranic word *Riba*, may remain as an area of future academic exercise for those who are interested in it. This has. however. nothing to do with the existence and development of this new discipline, Islamic economics.

3. The *Murabaha-Muajjal* mode is not necessarily unislamic but better to avoid it

Let us admit that it is the *Murabaha-Muajjal* mode which has helped the Islamic banking create its Islamic character, and at the same time it is this mode which has thrown it into severe criticisms. not only in the non-Islamic world but also in the Islamic world. Incidentally. this mode is being extensively employed by all the Islamic banks. including the IDB. of the world.

The practitioners treat this mode to be quite legitimate from Islamic point of view. It does not involve lending money but deals with buying and selling goods. When the bank buys goods from its clients. it takes ownership for some time. thus exposing itself to risk.

Admittedly, in their applications of *Murabaha*. the Islamic banks are keeping their ownership periods very short. a "millisecond" to use the terminology of the critics. One of their views is. "from an economic point of view. of course. an infinitesimal ownership period makes murabaha equivalent to an interest-based loan. The bank bears no risk. and the client pays for the time-value of money. There remains mainly a semantic difference which is that the client's payment is called a "service charge" or "markup" in one case and "interest" in the other" (1993. p.310). Referring to the study of Ciller and Cizakca (1989). he also says. "There is actually a precedent for treating the two terms as synonymous: an Ottoman ruling of 1887 that pegged interest

rates at 9 percent was named the "*murabaha* ordinance". Suleyman Uludag, just like a real Islamic preacher hastens to advise, "It is also a grave offense against God: even if interest were unlawful, it would be a lesser sin to deal in interest openly than to cloak it in practices aimed at deceiving Him" (1993, p.315).

Left to my conscience, I find substantial academic merit in both these views. One is striving to prove that the *Murabaha-Muajjal* mode is legitimate and Islamic; and the other is striving to show that *Murabaha* and interest as synonymous, or nearly the same: so that if interest is prohibited, *Murabaha-Muajjal* should also be prohibited. In both the arguments, time-value of money appears to be recognised.

To these I have two things to tell the critics and one thing to the practitioners. First, that *Murabaha-Muajjal* type mode can be, under the circumstances as described in the above argument, very dangerous and open the backdoor for dealing on the basis of interest, is NOT unknown in the Islamic circle. As noted in the text (Chapter 11), the *Report of the Council of Islamic Ideology of Pakistan* has warned the users about the indiscriminate use of this mode and Siddiqi has proposed to remove this mode "from the list of permissible methods altogether". Second, what they are saying is that the difference between M (*Murabaha*) and I (interest) is zero. In contrast, the consentitous Islamic scholars (e.g. Council of Islamic Ideology of Pakistan and Siddiqi) are saying that if the conditions for using M are not fulfilled[4], the difference between M and I "may tend to zero". Note that there is "sky-bottom" difference between when "something is zero" and when "something tends to zero". Mind that it is this concept on which the whole edifice of modern calculus depends. If this argument has any merit, then the preacher-like advice of Uludag would appear to be not only unnecessary, but also, in the true sense of the term, sinful.

The sinful act becomes more explicit when one carefully examines the illustrations given on page 314 by the author under review:

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[4] That is: (i) the goods needed by the clients are not bought and kept in its possession, and (ii) the goods are not sold to the clients.

"A wants to lend B $100 at 5 percent interest, without violating the ban. So he buys a chair from B in return for $100 and then promptly returns it for $105, payable in one year. The chair's ownership remains unchanged; B receives $100 now; and A stands to receive $105 in a year. While none of the individual transactions involve interest, together they are equivalent to a single transaction whereby A lends $100 to B at 5 percent per annum" (1993).

I leave it to the readers to find out the ruse of this example.

To the practitioners, not withstanding the merit of their arguments, it would be advisable to reduce the allocation of funds through this type of mode, if not possible to get rid of this completely, in the years to come. Although it has nothing to do for the existence of Islamic economics, reduction or avoidance of the *Murabaha-Muajjal* mode would help low down the voice of the anti-Islamic forces.

4. The PLS system is the best alternative to interest but is the most difficult one to implement

Perhaps the single most important and the least controversial contribution of Islamic economics is its emphasis on the profit-and-loss sharing (PLS) mode. Theoretically this method can take care of all the stated problems of the interest-based systems. First, while in the conventional interest-based system, loan decisions are taken primarily on the basis of credit-worthiness of its applicant, the PLS system focuses on the potentiality of the proposed projects. Thus in the later case an applicant with no collateral but an economically promising project can easily obtain the finance. Second, the conventional bank earns a predetermined rate of return in the form of interest, whereas the PLS system receives the share of profit (and losses, if any). Third, unlike the conventional bank, the PLS system offers the bank to participate in the execution of the project along with the clients. There are two prominent PLS modes, namely *Mudaraba* and *Musharaka*. Both these are partnership businesses. The former refers to a situation where the entire capital is provided by the bank and the entrepreneur provides the necessary labour and managerial services. The profit is shared according to pre-agreed ratio. The later, on the other hand,

refers to a situation where both the parties share capital and agree to share profit and loss in a specified rule.

In its application of the PLS techniques, let us openly admit, the performance of Islamic banks all over the world has been anything but poor. According to the International Association of Islamic Banks (1996), of the total investment made by the Islamic banks, only 11 percent in South Asia and 19 percent in the Middle East, were devoted to *Mudaraba* and *Musharaka*. In Bangladesh this percentage continuously declined from 6.5 percent in 1987 to 2.6 percent in 1997[5].

In chapter 12, an attempt has been made to identify the factors responsible for this poor performance. Let me ask the critics of Islamic economics once again to agree with me that this not-unexpected performance of the Islamic banks at this initial stage has nothing to do with the existence of the Islamic banks, and hence the Islamic economics. Following their own arguments this can gradually be remedied through such measures as training and re-training of the bank officials and removing the short-comings of the existing curriculum of both the formal educational institutions and the training institutions.

We can, therefore, ignore the highly-motivated finding of the critic, i.e. "This makes interest, a compensation mechanism that requires no monitoring, mutually preferable to profit-and-loss sharing" (1993, p.312). Instead, we sincerely believe that, given the commitment of the implementors, it would be possible to create an environment where the borrowers and lenders will willingly substitute the PLS system to interest and thus strengthen the base of Islamic economics.

5. The rise of islamic economics is not a threat to the Global Economy but it can very well serve as an aid to the ills of the capitalism

With the collapse of the Soviet economic system, the three-sided controversy has now boiled down to two, the Islamic economic

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[5] The figures refer to IBBL. Entire allocation was through *Musharaka*. There was no allocation through *Mudaraba* by the IBBL during the period under reference.

system vis-à-vis the capitalist system. The stand of Islamic economics is clear and unambiguous. Capitalism has basically failed to provide solutions to the world socio-economic problems. Let us admit that this particular attitude of Islamic economics has made many Western social scientists, as well as by many of our local friends trained in the Western education system (like me), dubious, hesitant, undecided and, above all, distrustful and suspicious about the role of Islamic economics. The later category (our economic friends) have so far remained virtually silent. The former category (the Western social scientists) have gone so far as to treat the discipline as "THREATS TO THE GLOBAL ECONOMY" (1997, p.83).

The former attitude is understandable, but where lies the threat? Is it not true that most of the countries of the world are presently run by the principles of capitalism? But why is the world economy beset with so many economic problems categorised as: general problems including poverty, inequality and unemployment; macroeconomic problems including inflation, budgetary deficits, debt-servicing and shortage of foreign exchange; and socio-moral problems including crime, alcoholism, drug addiction, child harassment, mental tension and suicide? According to the principles of Islamic economics, these problems are of crucial significance simply because these go against the uncompromising emphasis of Islam on human dignity, brotherhood and socio-economic justice.

Capitalism believes that the solutions to the above problems lie in the implementation of these three basic principles:

- Unfettered private property,
- The profit motive, and
- The market mechanism

What Islamic economics simply says is that these principles, left alone, can not give us the type of solutions we want to see in the society, particularly in the Muslim countries, unless and until the religion and morality are also considered relevant. More technically, unless and until the religion and moral factors are built-in in the so-called capitalistic principles we can not achieve the desired solutions. Is this suggestive reform a threat to capitalism, or the Global

economy? The Islamic economic system rather helps the capitalistic system get rid of its left-aside problems. A brief note is given below on this particular point.

Private Property: Islamic economics does not necessarily deny the importance of private property. What it adds is that if one has wealth, one must see that, as a wealthy man, one's social responsibility is not overlooked. Regarding the ownership of land, Islamic economics virtually puts no limit provided simply that one makes full, I repeat full, utilization of one's land resources and at the same time abide by the principles of *Shariah*.

Profit Motive: Islamic economics definitely allows the people to venture after profit under normal circumstances. What it insists is that this profit motive should not always guide them to take economic decisions. Wherever possible and needed, they should also inculcate altruistic motive.

Market Mechanism: In the true sense of the term, Islamic economics is not against market mechanism. It does not support the market intervention in the normal circumstances. The Islamic principle, "Allah fixes the price" implies three things, i.e. the market mechanism should be operated in such a way that:

- It helps increasing productivity of all sections of the society,
- It helps maintain social balance between the haves and have-nots, and
- It helps increase the real income of the poor

In other words, Islamic economics accepts market mechanism subject to behavioral norms of the *Shariah*. Therefore, Islamic economics is not a threat to the Global economy based on capitalistic norms but can very well serve as an aid to get rid of the ills from which the capitalistic economy has been suffering.

6. Some Quranic injunctions definitely offer choices and flexibility but not to ANY ONE who wants to use them to build an economic system

The Quran-and-*Sunnah* is the basis and hence the life-blood of Islamic economics. We shall definitely have to turn to these divine

sources and the wisdom of the earliest Islamic community in the seventh century Arabia for the solution of socio-economic problems of today. Given my reading of the literature, this basis of Islamic economics has been challenged and severely criticised by the secular social scientists; nay, whether we believe it or not, this is also the aspect which is standing on the popularity of the discipline even among many Muslim social scientists. Let us not shut our eyes to what they want to say. Their basic comment is, "Islamic economics applies ancient solutions to perceived problems of the present" (1993, p.305). According to them, the flaws of this assertion can be explained as under:

> "The Quran has not been of much help in this regard. It is not, after all, a treaties in political economy or a manual for economic governance. Of its thousands of verses, only about one-third of one percent provide economic directives. And these verses offer enormous choice and flexibility to any one who wants to use them to build an economic system. Accordingly, the juristic schools of Islam have differed with one another on numerous economic matters" (1997, pp.88-89). This goes with their earlier observation, the exponents of Islamic economics "claim routinely that their own particular positions are rooted in a well-articulated divine law that admits a single, unambiguous meaning" (1993, p.329).

Again:

> "...the seventh-century economy of the Arabian peninsula was very primitive. It produced few commodities, using uniformly simple technologies. It was essentially free of the major physical externalities that afflict modern economics, like air and water pollution. And it featured only the most rudimentary division of labor. This specific economic injunctions found in the Islamic scriptures – mostly in the *sunnah* – are responses to problems that arose in this ancient setting. Some of these injunctions were perceived as eternally valid. But many others were seen as changeable. Thus, rules and regulations were altered openly and unbashedly in response to new conditions. As a case in point, the scope and rates of *Zakat* underwent many modifications during the Golden Age" (1993, p.304).

I sincerely believe that the above quotations, out of many, would reflect adequately the views of the secular social scientists

including the sympathy implicitly shown by some Muslim ones. Let me put my own views one by one.

Firstly, Islamic economists never claim that the Quran (or even the *Sunnah*) is 'treaties in political economy' or for that matter a book of any subject as understood in this scientific age. What is claimed is that the Quran (and the *Sunnah*) along with other sources of Islamic knowledge can form the basis of any conceivable subject of the modern times. One can not assess the merit of a work by counting the number of sentences. It is the strength of the message that matters. Many have been writing thousands and thousands of pages just on one instruction i.e., "Allah hath forbidden *Riba*". Have we finished arguing with/against it? No. [**Loqman 31:27**]

Secondly, Islamic economists never claim that the nature and extent of socio-economic problems of today are similar to those of the seventh-century Arabian economy. What is claimed is that the "principles" employed in those days can still be applied. Let me mention one or two instances:

> **"...Verily never will Allah change the condition of a people until they change it themselves (with their souls)" [Rad 13:11].**

Can anybody, true to his conscience, deny the eternal guidance contained in this Quranic injunction for improving the socio-economic conditions of the people? Again:

> "Any one of you who gathers a bundle of fuel-wood (and carries to *Bazar*) on his back, is better than who begs from any one and he grants him or refuses (to grant) him" (**Al-Hadith**).

The example given in the above *Hadith* is certainly primitive, but can any one deny the importance of the eternal message it contained, even in this modern days? The message is: Islam encourages hard work and discourages begging.

Finally, they have identified contradictory views among the Islamic economists, and even among the Islamic jurists, regarding the interpretation of the "Divine Laws" (see the first paragraph above). Their findings can easily be reconciled. Some Quranic injunctions (not all) definitely offer some choices and flexibility, but NOT TO ANYONE who wants to use them to build an economic system. The persons concern must have sufficient knowledge about the following:

- The Quran and the *Sunnah*,

- Prevailing socio-economic tools, and
- Local situations in which their applications are intended.

When the Islamic economists routinely claim unambiguous meaning of the divine law, they obviously refer to the principles (which are fixed) and not to their interpretations (which may vary from circumstance to circumstance). Just one example may be sufficient here. The Quran says, **"Those who when they spend, are not niggardly, but hold a just (balance) between those (extremes)" [Furqan 25:67]**. The principle here is that an Islamic man will neither be extravagant nor be miser in his spending behaviour. Here the meaning of "extravagant" and "miser" would remain open. That is the exact meaning and interpretation of these terms may vary from one particular situation to another.

7. The institution of *Zakat* can never be dysfunctional or harmful, but we should be careful about its proposed reforms

I am convinced, *Zakat*, as an Islamic institution, can be regarded as one of the "ready-made" instruments for achieving the goals of Islamic economics. From the point of view of distributive justice, its role is unquestionable. But unfortunately, let us admit, we, both as theoreticians and practitioners, have so far failed to deliver its potential benefits to the society. Before we start discussing this, let us first of all, see what our critic-friend wants to say about the impact of *Zakat* in an Islamic economy.

> "In issuing such calls [i.e. calls for the immediate implementation of the holy laws of Islam (*Shariah*)], Islamic economics denies that certain economic problems of the modern age had no counterparts in the past. It also denies that once-beneficial institutions [such as *Zakat*] might now be dysfunctional, even harmful. Some of the rhetoric of Islamic economics thus conveys the impression that it seeks to rediscover and restore the economy of a distant past" (1993, p.305).

To this, my immediate reaction is that *Zakat* is not an economic institution in the sense as understood by the conventional social scientists. We must remember that first and foremost, *Zakat* (just like *Salat*) is an act of worship. The wealthy Muslims "purify and sanctify their wealth" by paying *Zakat* **[Tauba 9:103]**. It is the "poor

man's right" to receive *Zakat* **[Zariyat 51:19]**. In other words, *Zakat* represents a transfer of possessions, and not a favour or a gift, given by the owner of the wealth to those who have a right on it. Given this juristic interpretation, there is no scope of saying that once-beneficial institution (*Zakat*) might now be dysfunctional, or even would ever be so.

Of late, it is in the hands of social scientists, that *Zakat* is treated as an "institution". They see transfer of wealth and income from the rich to the poor, which actually gives rise to such concepts as "redistribution of income" and "reduction of inequality". It should be clearly understood that these are not the primary objectives of *Zakat* but a secondary ones.

The critic (under reference) has very thoroughly examined this secondary impact of *Zakat* with reference to Pakistan and Malaysia, where *Zakat* is administered by the government. I quote him once again. "Now I add that *Zakat* has not made a major dent in Muslim poverty and inequality. While it has obviously redistributed some income and wealth, it has not conferred substantial benefits on the poor as a group" (1993, p.325). Even if this observation is accepted as unbiased, is it correct to say that *Zakat* is "harmful"?

Given my reading, Islamic economics literature is full of controversy regarding the nature and extent of *Zakat* on the one hand and the justification of taxation in an Islamic economy, on the other. This appears to have created good atmosphere for the critics to play with. To my judgement, for the future of Islamic economics, several points need not only more thinking, but also, at the same time, more re-thinking.

There are Islamic economists (e.g. Monzer Kahf) who strongly believed that in an Islamic state, there is little justification of taxation as the *Zakat* funds should be enough to meet the "necessary" expenditure of the government. There are others (e.g. Umer Chapra) who opine that taxation is well justified in Islam. To my viewpoint, Chapra is right. Given the role of a modern government, it would be too much to think of meeting all the government expenditures, nay all types of expenditures, with *Zakat*, and *Zakat* alone. We must not forget, as stated above, *Zakat* is a special type of levy and it has special purpose too.

Attempts are being made in the Islamic economics literature to introduce changes in the rates, coverage and *Nisab* of *Zakat* in the name of reforms. Some of the proposed reforms have been discussed in Chapter 14 on *Zakat*. Given my limited knowledge, I believe that the proposed reforms if introduced would create more problems than they would solve. This will be particularly so, if we insist on progressive taxation to stay side by side the *Zakat*.

The rate is well defined in the *Hadiths*. It varies between 2.5% and 20% depending upon the type of commodities one considers. I think, these rates should be allowed to remain untouched. There is no question of the rate being low. It is presumed that the *Zakat*-payers would also have to pay taxes. The items of *Zakat* as specified in the *Hadiths* should also be allowed to stay unchanged, except minor adjustment made here and there when the circumstances so warrant. It will be complicated to strive to bring such goods as houses, machinery, companies, hidden wealth (e.g. bank deposits) and the like under *Zakat*. The countries which have done so are not showing encouraging results.[6]

Regarding the controversy between voluntary and obligatory mode of *Zakat*, I would like to opine that the latter should always be preferred to the former. But so long the government does not, or can not, come forward to take up the responsibility of administering the *Zakat*, it should be left to the individual management.

Therefore, for the future of Islamic economics, it may be recommended that the nature and extent of *Zakat* as conceived from the Quran and the *Sunnah*, should be allowed to remain unchanged and allow taxes to play as an important source of revenue of the government.

8. Let us not allow the prohibited indexation to be mixed up with such permitted modes as mark-ups, commissions and service charges

This is another area where the anti-Islamic economic force is in action. The issue of indexation is related to the question of *Qard Hasan*, a benevolent or interest-free loan, as mentioned in the Quran.

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[6] See Chapter 14 on *Zakat*.

From conventional economic wisdom, it is understood that if a free loan is to be given it is neither the lender nor the borrower should bear any extra burden. That is, the borrower should pay back the same amount he received and the lender should receive the same amount he lent. But what happens when there is inflation i.e. when the value of money declines. The controversy is whether the nominal rate of return that must be zero or the real. In other words, should the loans be indexed to the rate of inflation to protect the purchasing power of the lender? Its answer can not be directly derived from the *Shariah*. It is, therefore, a question of interpretation. Islamic economists such as Mannan (1984) and Hassanuz Zaman (1985) argue that indexation is not only legitimate but also a requirement of justice. However, two International Conferences on Indexation (one held in Islamabad in 1986 and the other held in Jeddah in 1987) reached the conclusion that indexation is incompatible with Islam. To this the question raised: "Nevertheless, the Islamic banks index their markups, commissions, and service charges to inflation" (1993, p.314).

To my judgement, the question raised is, in a sense, meaningless, because Islamic banks (or for that matter any conventional banks) never index their commissions or service charges to inflation. If they do this would imply that the commissions (for example) charged by the banking institutions would be zero when there is no inflation in the country. Is it rational, or sensible? No. Therefore, let us not mix up the prohibited indexation with such permitted modes as mark-ups, commissions and service charges frequently employed by both the Islamic and conventional banks.

9. Islamic economics is not a set of rituals but a way of honourable living

Unlike conventional economics, Islamic economics recognises very clearly the role of moral values in economic development. Translated in economic terms, it means that the individual persons are encouraged to enjoy the bounties of Allah, but they must be willing to share their possessions with others, with the less fortunate including their own relatives. They must not abuse the resources at their disposal and keep them un- or underutilised. As producers or traders, they are

free to seek personal profit, but in exercising this freedom they must avoid harming others. Their earnings must be lawful, that means, their earnings must not be more than their efforts justify. They must pay fare wages to their employees and must not hold goods for long time in order to derive the benefit of higher prices during the period of crisis. They must be honest in their economic dealings, admit their mistakes and avoid false advertisement. They must be prepared to put in hard labour when and where necessary.

Neglect of these economic values by the secular economics, and clear and unambiguous recognition by Islamic economics is enough, to my view point, to justify the case for the latter as a separate discipline.

The critics are arguing that Islamic economics is destroying a number of economic sectors including video stores, theaters, dance clubs, bars and hotels that cater to "naked" tourist and restaurants that serve food during fasting times and that "in Egypt, attacks against tourists and tourism establishments have lowered foreign exchange earnings, thus harming investment and growth" (1997, p.76). To this, Islam, and hence Islamic economics, makes no compromise: its view is unambiguous and final, one's earnings must be lawful (*Halal*). However, if Islamic economics (as per opinion of the critics) is held responsible for the reduction of the income of the rich (e.g. from the hotels that cater to the "naked" tourists), it is also responsible for the increase of social welfare of the poor. As in their own words, "In Egypt, mosque-affiliated clinics are delivering health services at rock-bottom prices, generally more efficiently than over-burdened health facilities run by the government, where a poor Egyptian might wait three months for an X-Ray at government facility, at an Islamic clinic access to the procedure typically takes much less" (1997, p.77).

Therefore, Islamic economics is not a set of rituals but a way of honourable living.

10. The 21st century for Islamic economics would be a period of infinite hope and promise followed by economic development with socio-economic justice

In the hands of the critics, the nature and scope of Islamic economics appears to have been highly confusing. This last section,

therefore, categorically re-iterates that it is not, as they want to prove, a set of rituals derived from the Quran and the *Sunnah*. Nor is it, as understood in their circle, equivalent to such institutions as *Zakat* and Islamic banking. It actually aims to provide a comprehensive blueprint of all economic activities including consumer behaviour, firm behaviour, market structures, money and banking, public finance, economic development, and international trade.

Islamic economics stands for socio-moral justice and efficiency to be achieved through growth and employment creation. It is very much concerned with equitable distribution of income and wealth, and reduction (not elimination) of inequality. Its purpose is to create a poverty- and exploitation-free society associated not only with interest but also with anything that tends to promote them.

Their observation, "In some Egyptian Islamic circles, a prospective bride demands nothing from her future husband but a deep commitment to Islam. Moreover, before she accepts and her family agrees to the marriage, the groom must prove, usually through an oral quiz, that he has sufficient religious knowledge" (1997, pp.82-83). I understand that this attitude of the bride is very disturbing particularly for those of us want to measure everything in terms of monetary benefits. But, I can assure him that one will not see its light in the Islamic economics, as in it, religion encompasses all public realms, such as science, law, politics and economics. So, when the Egyptian bride puts emphasis on religious knowledge, she would take it in its comprehensive sense and would find the knowledge contributing not only to her own welfare but also to human welfare in general.

Islam, and hence Islamic economics, does not neglect the material prosperity of the people (see chapter 17). Therefore, it is not at all anti-Islamic when one finds that "Relative to poor *Islamist* women, prosperous ones tend to wear more expensive and stylish veils" (1997, p.83).

Islamic economics, as a discipline, is not a product of any particular political party as they are trying to justify:

> "To my knowledge, there have been no systematic surveys to determine the true popularity of Islamic economics. But certain predominantly Muslim countries have held secret-ballot elections

> that have given voters the option of supporting an Islamist party. In many of these elections Islamist have received far less support than the tenor of public discourse might have led one to expect" (1997, p.91).

Given that thousands of books and articles on Islamic economics have already been published, that hundreds are being added every year, and that "the serious process of revival and rediscovering of Islam" by both the Muslim and non-Muslim worlds have already begun, it would be absolutely absurd to accept the remark that the discipline belongs to any particular "Islamist party". If that would be true, then how one would view the enthusiasm and interest being shown by the Western conventional banks including some multi-national giants such as the World Bank and the International Monetary Fund or the creation of Islamic Economics Chair by the Rice University (USA) or the establishment of the Forum on Islamic Finance by the Harvard University or the introduction of Islamic Finance and Investment Practices by the K&S (a leading Law Firm in the USA) or launching of Dow Jones Islamic Market Index (DJIMI) by the Dow Jones and Co. (Publisher of the Wall Street and Interactive Journal) covering 600 companies of 30 countries including USA or specialization being made by such non-Muslim renowned economist as Professor Rodney Wilson (UK)? Do they belong to any "Islamist" party? Rather, contrary to what is observed, to my viewpoint, both the discipline (Islamic Economics) and its applications enjoy the moral sanctions of all faculties and have public support of intellectuals, politicians and general masses who are committed to see an exploitation- and poverty-free peaceful world. I am sure, their "apprehension" may not be completely baseless as:

> "...religion [Islam] is everywhere becoming more vocal, more open, and more demanding than it was, say, in the 1960s, a time when secularization was pushing religion progressively into the private realm" (Casanova as quoted in 1997, p.96).

Therefore, when this observation (of the critics) is combined with our assertions, the inevitable conclusion on the future of Islamic economics stands as:

> **The 21st century would become for Islamic economics a period of infinite hope and promise followed by rapid economic development with socio-economic justice.**

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MODEL EXAMINATION QUESTIONS

CHAPTER 2: ISLAMIC ECONOMICS – WHAT AND WHY?

1. What is Islamic economics? Discuss the sources of Islamic economics knowledge. How do they differ from Socialist economics and Capitalist economics?
   For Answer: See Sections 3 & 1.
2. What are the principles of Islamic economics? Discuss the nature and scope of Islamic economics.
   For Answer: See Sections 5 & 7.
3. Discuss the importance of the study of Islamic economics. How does Islamic economics differ from conventional economics? Explain.
   For Answer: See Section 8 & 9.
4. Discuss the basic assumptions of Islamic economics. How do they differ from conventional economics? Can Islamic Shariah be changed?
   For Answer: See Sections 4 & 2.
5. Write short notes on: (a) Islamic Economic Man, (b) Revealed Knowledge, (c) Dual Accountability, and (d) Composite Social Science.
   For Answer: See Sections 4(c), 2(a), & 3.

CHAPTER 3: THEORY OF ISLAMIC CONSUMER BEHAVIOUR

1. Distinguish between 'positive economics' and 'normative economics'. Is Islamic economics positive or normative or both? Comment on the theory of conventional theory of consumption behaviour from an Islamic perspective.
   For Answer: see Section 2(c), Section 1.
2. Who is an 'Islamic Consumer'? How does he differ from an 'Economic Consumer'? Discuss the contribution of Fahim Khan towards a theory of Islamic consumer behaviour.

For Answer: see Section 2(a), Section 3(a).

3. Distinguish between 'Worldly Consumption' and 'Consumption for the sake of Allah'. Critically examine the contribution of Monzer Kahf towards a theory of Islamic consumer behaviour.
   For Answer: see Section 2(b), Section 3(b).
4. Discuss the contribution of Anas Zarka towards a theory of Islamic consumer behaviour.
   For Answer: see Section 3(c).
5. Write short notes on: (a) self-sufficiency threshold, (b) Islamic asceticism, (c) Islamic success, and (d) Zero reward.
   For Answer: Find out.

CHAPTER 4: ISLAMIC THEORY OF DEMAND AND SUPPLY

1. Distinguish between 'demand' and 'effective need'. Review the conventional theory of demand and supply from an Islamic perspective.
   For Answer: see Section 2(a), Section 1.
2. What do you mean by 'effective need' and 'effective supply'? Show importance of their analysis in the context of Islam.
   For Answer: see Section 2(a), Section 2(c).
3. What 'Critical Islamic Concern Line'? Discuss the importance of its identification in the context of Islam.
   For Answer: see Section 2(b).
4. Write short notes on: (a) Islamic demand and Islamic supply curves, (b) Potential consumer gap zone and potential producer gap zone, and (c) Transfer payments.
   For Answer: see Section 2(c), Section 2(b), and Section 3c(ii).
5. 'The basic issue arising out of the analysis of the 'Islamic demand and Islamic supply' lies in converting the socially indifferent consumer's and producer's surpluses in to a humane and socially concerned use and exchange'. Explain.
   For Answer: see Section 3.

CHAPTER 5: FACTORS OF PRODUCTION AND THEIR PRICING IN AN ISLAMIC PERSPECTIVE

1. How would you categorise and measure the factors of production in Islamic economics? For the purpose of factor pricing, show the justification of combining capital and entrepreneurship in an Islamic economy.

   For Answer: see Section 1, Section 2(b)(ii) pricing of capital and entrepreneurship
2. Evaluate the Marginal Productivity Theory of Distribution from an Islamic perspective. Explain the procedure of pricing labour in an Islamic economy. Do you any comments to make?

   For Answer: see Section 2(a), Section 2(b) (ii) pricing of labour
3. Explain the meanings of *Mudarabah* and *Musharaka* as forms of Islamic business. Discuss how pricing of capital and entrepreneurship is made under these two forms of business.

   For Answer: see Section 2(b)(ii) pricing of capital and entrepreneurship
4. Discuss the Islamic principles of factor pricing and income distribution. Show their application in determining the price of labour in an underdeveloped Muslim country like Bangladesh

   For Answer: see Section 2(b) (i), 2(b)(ii) pricing of labour

CHAPTER 6: TOWARDS A THEORY OF ISLAMIC FIRM

1. What is an Islamic Firm? Discuss its basic characteristics as distinguished from traditional firm.

   For Answer: See Section 1, Section 2.
2. (a) 'Equilibrium in Islamic Firm is not unique as in the traditional firm'. Discuss

   (b) 'An Islamic Firm does not necessarily aims at maximising profit'. What are the alternatives?

   For Answer: See Section 2(c), Section 2(d).
3. Discuss the Behavioural Model of an Islamic Firm as propounded by Metwally.

   For Answer: See Section 3.

4. Write short notes on: (a) Right of Islamic ownership, (b) Islamic civil laws, (d) Guidelines for Islamic business firms.
   For Answer: See Section 2(a), Section 2(b), Section 2(d).

CHAPTER 7: MARKET STRUCTURE IN AN ISLAMIC PERSPECTIVE

1. What is perfect competition? Comment on this type market structure from an Islamic perspective.
   For Answer: See Section 1
2. Distinguish between 'Natural Monopolist' and 'Artificial Monopolist'. What is the attitude of Islam towards monopoly? Is advertising permissible in Islam?
   For Answer: See Section 2(b), Section 4
3. Explain the price-quantity relationship under Monopoly in a conventional framework. How do you find the pricing principle consistent with Islamic values in this case?
   For Answer: See Section 2(c)
4. What is Oligopoly? How do you find an Islamic dimension in the analysis of the kinked demand curve? Explain.
   For Answer: See Section 3(a), Section 3(b)

CHAPTER 8: ISLAMIC THEORY OF CONSUMPTION FUNCTION

1. What is Consumption Function? Comment on the Keynesian Consumption Function from an Islamic perspective.
   For Answer: See Section 1.
2. Distinguish 'Current Consumption' and 'Actually Needed Current Consumption'. Discuss in this connection the contribution of Mannan.
   For Answer: See Section 2(a).
3. What does 'Spending for the Cause of Allah' mean? Discuss the contribution of Ausaf Ahmad towards the Theory of Islamic Consumption Function.
   For Answer: See Section 2(b)
4. Distinguish between: (a) Disposable Income and Expected Desirable Income, (b) *Zakat* and *Infaq*, and (c) Worldly Consumption and Consumption for the sake of Allah.
   For Answer: See 2(a), 2(b)+, 2(b)+.

CHAPTER 9: SAVINGS AND INVESTMENT BEHAVIOUR IN ISLAM

1. Define 'Savings' and 'Investments'. Show how decisions of savings and investments are taken in the traditional financial system. Comment from an Islamic perspective.
   For Answer: See Section 1.
2. Show how saving and investment decisions are taken in an economy where the tool 'interest' is function less. How do they differ from the traditional economy?
   For Answer: See Section 2(a).
3. Discuss the basic characteristics of the Islamic financial system. .Are saving and investment adversely affected under the PLS system?
   For Answer: See Section 2(b)+.
4. What is meant by 'Stability of the Financial System'? Which system is more stable, PLS or traditional? Give reasons for your answer.
   For Answer: See Section 2©+

CHAPTER 10: MONEY

1. Distinguish between 'Narrow Money' and 'Broad money'. Discuss the role of money in an Islamic economy.
   For Answer: See Section 1(a), Section 1(b)
2. Examine the basic assumptions of the Quantity Theory of Money from an Islamic perspective.
   For Answer: See Section 1C
3. Examine the instruments of Islamic monetary policy.
   For Answer: See section 2(a)
4. Write short notes on: (a) Moral suasion, (b) Value-oriented allocation of credit, (c) Primary and derivative deposits, (d) deficit financing in Islam, and (e) foreign exchange swap.
   For Answer: See text

CHAPTER 11: ISLAMIC BANKING : THEORY

1. What is an Islamic bank? Discus its characteristics. In what ways do these characteristics differ from those of the conventional banking?
   For Answer: See Section 1(a), Section 1(b)

2. What is *Riba*? Is it different from 'interest'? Show the economic arguments against *Riba*.
   For Answer: See Section 1(c)
3. Briefly discuss the Islamic modes of financing. To what extent are *Mudarabah* and *Musharakah* applicable in the traditional economic system.
   For Answer: See Section 2
4. Discuss the role of Central Banking in an Islamic economy.
   For Answer: See Section 4
5. Write short notes on:
   (a) Social Investment Bank Limited: its uniqueness
   (b) *Qard Hasan*: its importance in the modern society
   (c) *Riba* and profit: distinction
   (c) PLS system: its significance in the economy.
   For Answer: See Section 5, Try yourself, Section 1(c), Try yourself.

CHAPTER 12: ISLAMIC BANKING : PRACTICE

1. Discuss the evolution and experiences of Islamic Banks around the world.
   For Answer: See Section 1
2. Examine the role of Islamic Development Bank in promoting the spirit of Islamic Banks in the Muslim world,
   For Answer: See Section 2
3. Examine the role of the Islami Bank Bangladesh Limited in (a) popularising Islamic modes of financing and (b) promoting *Adl* and *Ihsan* in the society.
   For Answer: See Section 4
4. What are the constraints that the Islamic banks are facing in Bangladesh? How do you propose to remove them?
   For Answer: See Section 6, Section 7
5. Compare the performances of the Islamic banks and conventional banks with reference to the experiences as gained in Bangladesh.
   For Answer: See Section 5

CHAPTER 13: ISLAMIC PUBLIC FINANCE: PAST AND PRESENT

1. Discuss the Islamic principles of public finance. Show the linkages between the sources of revenues and heads of expenditures that one can establish on the basis of the Quran.
   For Answer: See Section 1, Section 2(c)
2. Discuss the heads of expenditures and sources of revenues in an early Islamic period. Have these sources any relevance to the present world situations?
   For Answer: See Section 2 +
3. Explain the heads of expenditures and sources of revenues of a modern Islamic state. How do they differ from those of the traditional state?
   For Answer: See Section 3
4. Explain the meanings of: (a) *Israf,* (b) *Daruri,* (c) *Haji,* (d) *Tahsini.,* (e*) Fard Kifayah.*
   For Answer: See Section 1, Section 3 +
5. Distinguish between:
   (a) Permanent expenditure and (b) Expenditure based on present circumstances, and
   (b) 'The necessary' and 'The needed' expenditures.
   For Answer: See Section 1, Section 2.

CHAPTER 14: ISLAMIC FISCAL POLICY : THE ROLE OF *ZAKAT*

1. Distinguish between *Zakat,* Tax and *Sadaqa.* Discuss the principles of *Zakat* distribution in an Islamic economy.
   For Answer: See Section 1©, Section 3
2. Explain the concept '*Zakat*'. Discuss the socio-economic impact of *Zakat* with reference to a developing economy like Bangladesh.
   For Answer: See Section 5 +
3. What are controversial issues of *Zakat* in the modern days? Do you have any suggestions to deal with them?
   For Answer: See Section 6
4. Define *Zakat.* What are the principles of *Zakat* policy? Discuss the impact of *Zakat* on the savings behaviour of the *Zakat*-recipients and *Zakat*-payers.
   For Answer: See Sections 1, 4, & 5.

5. Write short notes on: (a) *Nisab,* (b) *Zakatable* items, (c) rate of *Zakat.*
   For Answer: See text

CHAPTER 15: ISLAMIC FISCAL POLICY : THE CASE OF TAXATION

1. Distinguish between *Zakat, Sadaqa* and *Infaq.* Show how the basis of taxation is derived out of the Quranic concept *Infaq/Sadaqa.*
   For Answer: See Section 1
2. Show the justification of taxation in an Islamic framework. Discuss the factors that you would consider in designing an Islamic tax structure.
   For Answer: See Section 1(d), Section 3
3. 'Tax is a last resort of public revenue in an Islamic economy'. Discuss.
   For Answer: See Section 3
4. What are the objectives of taxation policy in Islam? Discuss the implication of linking the tax system with *Zakat.*
   For Answer: See Section 2, Section 3
5. Write short notes on: (a) The road from *Infaq/Sadaqa* to taxation, (b) Mix of direct and indirect tax, and (c) Just tax system.
   For Answer: See Section 1, Section 2

CHAPTER 16: CO-OPERATION AMONG MUSLIM COUNTRIES

1. Discuss the basic characteristics of Muslim countries as enrolled in the OIC. Illustrate your answer with reference to both agriculture-based and oil-rich countries.
   For Answer: See Section 1
2. What is the rationale of economic co-operation among Muslim countries? Answer this question by referring to both ideological and economic reasons.
   For Answer: See Section 2
3. Identify the potential areas of co-operation among Muslim countries. What type(s) of co-operation would you recommend between Bangladesh and Saudi Arabia?
   For Answer: See Section 3

4. What are the problems that stand on the way of co-operation among Muslim countries? Suggest policy measures in this connection.

   For Answer: See Section 5, Section 6
5. Explain the importance of an appropriate institutional framework for reaping the benefits of co-operation among Muslim countries. Discuss the possibility of creating an Islamic Common Market among the Muslim counties.

   For Answer: See Section 4.

CHAPTER 17: ECONOMIC DEVELOPMENT AND ISLAM

1. Define 'Islamic Economic Development'. Discuss are the basic features of Islamic Economic Development? In what ways are they differ from the concept conventional economic development?

   For Answer: See Section1.
2. Explain the meaning of '*Ibadah*' as used in Islamic economics. Is Islam an obstacle to economic development? Discuss.

   For Answer: See Section 2.
3. Distinguish between Economic Poverty and Islamic Poverty. Discuss the Quranic views on poverty. Are these views applicable in the modern society?

   For Answer: See Section 3.
4. To what extent the per capita income real income can be used as an indicator of economic development? Can you find out the indicators of economic development as suggested by Islamic economists?

   For Answer: See Section 4.
5. (a) 'Islam hates the poverty but loves the poor' – elucidate

   (b) Discuss the role of Islamic government in economic development.

   For Answer: See Sections 2 & 6.
6. Write short notes on: (a) principles of product mix in Islam, (b) Classification of needs from an Islamic perspective, and (c) Growth and equity.

   For Answer: See text.

CHAPTER 18: GOALS AND STRATEGIES OF DEVELOPMENT IN ISLAM

1. What are the goals of Islamic economic development. In what ways are they different from those of the conventional economic development?
   For Answer: See Section 1
2. What are the strategies of Islamic economic development? Do you find any difference between these strategies and those of conventional economic development? Explain.
   For Answer: See Section 2
3. Write short notes: (a) Significance of Allah-gifted resources, (b) Importance of balanced development, and (c) Meaning of Islamic technology.
   For Answer: See Sections 1 & 2
4. Discuss the significance of 'export substitution' as opposed to 'import substitution' in the Islamic economic development.
   For Answer: See Section 2 +
5. Discuss the meaning and significance of 'Total Human Development' in the context of Islamic economic development.
   For Answer: See Section 2 +
6. Distinguish between 'Functional Distribution' and 'Distribution of Personal Income'. Discuss the tools and schemes for achieving distributive justice in the Islamic society.
   For Answer: See Section 3

CHAPTER 19: MOBILISATION OF RESOURCES FOR ISLAMIC ECONOMIC DEVELOPMENT

1. Explain the significance of mobilisation of resources for economic development in Islam. Discuss the financial resources from an Islamic perspective.
   For Answer: See Section 1
2. Discuss the role of human beings as a source of development resource with reference to a developing country like Bangladesh.
   For Answer: See Section 2

3. (a) Small vs big projects
   (b) Self-employment vs wage-paid jobs, and
   (c) Formal vs informal sectors.
   As strategies for human development programme for a developing Muslim country which one would you prefer and why?
   . **For Answer:** See section 2(b)
4. For self-employment in which area or areas, in your views, the Government should intervene: (a) ability to produce, (b) ability to market and (c) access to the required capital? Explain
   For Answer: See Section 2©
5. Distinguish between: (a) Voluntary savings and forced savings, (b) Foreign aid and foreign direct investment, and (c) Below subsistence welfare and above subsistence welfare.
   For Answer: See Section 1

CHAPTER 20: WOMEN IN ISLAMIC ECONOMIC DEVELOPMENT

1. Distinguish between an 'Islamic Women' and an 'Economic Women'. Show the position of women in Islam.
   For Answer: Try yourself and see Section 1
2. Discuss the sphere of economic activities of Islamic women in the light of *Shariah*. How do they differ from modern women? Is there any scope for increasing the sphere of economic activities from an Islamic perspective in Bangladesh?
   For Answer: See Section 2.
3. Discuss the nature and extent of women employment in Bangladesh. Do you have any observation and suggestion on their role from an Islamic perspective?
   For Answer: See Section 3.
4. Comment:
   (a) Self-employment of women and the role of NGOs in Bangladesh from an Islamic perspective.
   (b) Wage-employment of women and the role of Garments Industries in Bangladesh.
   For Answer: See Section 3.

6. Discuss the constraints to women participation in industrial development in Bangladesh from an Islamic perspective. Suggest way and means for their solutions

   For Answer: See section 3.

CHAPTER 21: THE ISLAMIC WORLDVIEW AND THE ISLAMIC RESPONSES TO THIRLD WORLD SOCIO-ECONOMIC PROBLEMS

1. Give a brief description of the socio-economic problems being faced by the Third World countries. Discuss the Islamic worldview as the basis for seeking solutions to these problems.

   For Answer: See Section 2 & 1
2. State the importance of 'man' as an engine of economic development. How would you propose to activate human factor for Islamic economic development?

   For Answer: See Section 2a.
3. Distinguish between needs, luxuries and intermediate goods as defined by Chapra. Discuss the economic reforms that are needed to achieve the Islamic economic goals with reference to government finance.

   For Answer: See Section 2b.
4. Discuss the natural extent of distribution of income and wealth in a country like Bangladesh. Suggest measures from an Islamic perspective for dealing with this problem.

   For Answer: See Section 2c.
5. What are the objectives of financial reforms? Discuss some measures that can help achieve the Islamic socio-economic goals.

   For Answer: See Section 2d.
6. Write short notes on: (a) Moral Filter, (b) Production Priorities, (c) Small and Micro Enterprises, (d) Distributive Reforms and (e) Law of Inheritance.

   For Answer: See Text.

ABOUT THE AUTHOR

Professor M.A. Hamid was born to a respectable Muslim family at Sirajgonj, Bangladesh in December, 1939. After studying at the University of Rajshahi, Bangladesh he joined the Department of Economics as Lecturer in 1963 and rose to Professorship in 1976. He was awarded the Commonwealth Scholarship to do a Master (1969) and Ph.D. (1972) at Manchester University, UK. He was appointed Vice Chancellor, Islamic University, Kushtia in June 1991 by the Government of the People's Republic of Bangladesh and left the office in March 1995. He was a Visiting Fellow of Wye College, UK. in 1978-79. After his retirement from the Department of Economics, Rajshahi University he joined Darul Ihsan University, Dhaka as the Vice Chancellor, in November, 2000 the post he served till his death in Chicago, USA, of lung cancer in November 2002.

He was a renowned social researcher and published extensively in the filed of irrigation, agriculture and rural development. Under his able guidance and determined leadership a series of research work under the name ***Rural Development Studies*** was published from the Department of Economics, Rajshahi University. Later his interest was shifted to the study of Islamic economics. To his credit he had more than 100 publications in the learned journals of home and abroad. He published dozens of research monographs and half a dozen books of which ***Irrigation Technologies in Bangladesh*** (1978) received the recognition of a milestone. His ***Palli Unnayan Bangladeshe*** (1988) (Rural Development in Bangladesh) was widely acclaimed. Among his other important publications ***Lathyrism in Bangladesh : An Agro-Economic Survey*** (1986) and ***Silk Sector in Bangladesh : A Selective Overview*** (1991) drew attention of the concerned people.

He was a distinguished fellow and member of many learned bodies and held various statutory positions in public universities of the country. He was member, University Grants Commission (1981-83), member, UNESCO Bangladesh Commission (1980-82) and member, Board of Governors of the Islamic Foundation Bangladesh (1991-95). While he was in the UK he collected money for the War of Liberation of Bangladesh. He was a widely traveled man and participated in scores of national and international seminars and conferences.